

**The Western Balkans and the Ukraine crisis –  
a changed game for EU and US policies?**

**A DPC Policy Paper**

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## TABLE OF CONTENTS

EXECUTIVE SUMMARY AND RECOMMENDATIONS.....	I
INTRODUCTION.....	1
RUSSIA’S REGIONAL ROLE/POSITION BEFORE THE UKRAINE CRISIS .....	1
IMPLICATIONS OF THE UKRAINE CRISIS .....	6
ENERGY POLICY AND GEOPOLITICS.....	12
EU-US REACTIONS TO THE NEW CHALLENGE.....	18
POSSIBLE IMPACT ON EU-US WESTERN BALKAN POLICY - CONCLUSION AND RECOMMENDATIONS .....	22

## EXECUTIVE SUMMARY AND RECOMMENDATIONS

Well before the ongoing Ukraine crisis began in late 2013, Russia had asserted itself in the Western Balkans politically, often using economic leverage to that end. A lack of Western unity has enabled Moscow's efforts. Russian interests are in play throughout the region, but are most problematic in Serbia and Bosnia and Herzegovina, the latter through the Serb entity, the Republika Srpska. The full extent and nature of these relationships are shrouded in opacity. Yet both are increasingly problematic for Western interests, and even European security.

The conflict in Ukraine, and the resulting impact on the relationship between Russia, the EU and the US, has affected developments in and around the Western Balkans in different ways. The Ukraine crisis has drawn Western policy attention away from Balkans. Yet the region has become an additional proxy battlefield in this new geopolitical conflict, symbolized by intensified Russian diplomatic and propaganda activities aimed particularly, but not exclusively, at Serbia. The various international and Western Balkan actors have occupied different policy positions. The EU among its 28 members, the EU as a corporate body and the US, have struggled to articulate a joint policy position to counter Russia's aggression in Ukraine, often based on varying levels of economic – and especially energy – interdependence with Russia. Security perceptions vary according to both distance from Russia and the historical nature of the relationship, with Baltic states and Poland most adversarial in their posture toward Moscow. In parts of the Western Balkans where a joint Western policy had already coalesced, such as with the Serbia-Kosovo dispute, the EU and the US have maintained a common policy despite the differences in confronting the challenge posed by the Ukraine crisis. Yet in Bosnia and Herzegovina, Western reactions mirrored the existing policy divide. It remains to be seen whether the roles and opportunities of European and American energy companies in the Western Balkans will be affected by the Ukraine crisis or whether they will influence individual Western countries' policies towards the region. Yet at present, the Ukraine crisis has added substantial resolve to the European Commission's already standing existing objections to the *South Stream* pipeline in Bulgaria (and Serbia) for its breach of EU regulations, to the dismay of the six EU member states participating in the project.

The countries of the Western Balkans have reacted differently to the Ukraine crisis. Montenegro fully aligned with the EU's Russia policy, including the introduction of sanctions. The government took the risk of breaking with its historical ally Serbia and alienating traditional pro-Russian sentiments among parts of the political elite and the society. It was left without the reward it had hoped for: the granting of NATO membership at the Alliance's September summit in Wales. The reasoning behind NATO's decision remains opaque. In Bosnia and Herzegovina, the Ukraine crisis provided a pretext for local political actors to pursue previous positions afresh. According to Western diplomatic sources, the Russian annexation of Crimea encouraged BiH's Republika Srpska entity President Milorad Dodik to consider undertaking concrete steps toward the entity's long-threatened secession, allegedly with Russian support. According to these sources, only Serbian Prime Minister Aleksandar Vučić stopped Banja Luka through his refusal to support such a move. In Serbia, the Vučić government has struggled to maintain a tactical balance between its goal of EU integration and its special relationship with Russia. Vučić has declared this policy of "the EU and Russia," and subsequent refusal to join EU economic

sanctions, to be based on Serbia's national interests. Without explicitly spelling out what these national interests are, Vučić most probably referred to the country's economic dependence on Russia, especially in the energy sector – a disadvantageous relationship that represents a heritage of the more recent past. Serbia's public and citizens seem to be stuck between a traditional romantic picture of Russia and majority support for EU membership. The EU, for the time being, has accepted Serbia's balancing act and refusal to harmonize with EU sanctions. Yet while Belgrade obviously lacks a long-term strategy on when and how to break its traditional relationship with Russia, which contradicts its aspiration of EU membership, the EU also clearly lacks a long-term strategy on how to deal with Serbia. This void will become more acute if relations between Russia and the West deteriorate even more dramatically.

The West, particularly the European Union, must finally rise to the challenge and assemble a comprehensive policy toward the region to limit Moscow's capacity to create mischief and undermine Western interests. This joint Western strategy should include the following elements: a credible posture to address regional security threats regionwide, including the leverage afforded by NATO membership aspirations; further development of the EU's enlargement approach to ensure full conformity with the EU's Common Foreign and Security Policy (CFSP); and development of a common energy policy which includes EU and NATO membership candidates.

To this end, DPC proposes the following:

- The EU and the US should join forces to resolve outstanding structural policy challenges. This applies to those on which some progress has been made (Serbia and Kosovo), but also to those that have remained on the back burner: Bosnia and Herzegovina and Macedonia. Filling the power vacuum in the region will reduce Russia's latitude to act as a spoiler.
- In Bosnia and Herzegovina, the EU and the US should agree on a contingency plan to replace EUFOR with NATO troops, making use of the UN Security Council Chapter 7 mandate held by NATO headquarters in Sarajevo. They should announce this plan to Russia in advance of the November Security Council vote on EUFOR extension in order to deter a Russian veto. EU members who have advocated ending EUFOR's executive mandate in the past – Germany, France, and Italy – should align behind maintaining a peacekeeping mission for security and geopolitical reasons.
- At its Wales summit in September, NATO should offer Montenegro a *conditional* green light with clear reform benchmarks, setting a date in 2015 to enact membership if Montenegro meets a set of clear conditions in full. In this way, the Alliance would motivate Podgorica to implement the remaining reforms, lend the Montenegrin government the support it needs to lobby citizens for NATO membership, and meet NATO's geopolitical needs and interests that arise from the Ukraine crisis.
- The EU should strategically use the accession process as a lever to enforce *full* harmonization of candidate countries' foreign and security policies with the Union's Common Foreign and Security Policy (CFSP), taking current geopolitical challenges into account. This is particularly

important in the case of Serbia. The EU should keep negotiations on Chapter 31 (foreign, security and defense policy) - open until it deems it most appropriate strategically. It should also set benchmarks, including interim benchmarks in order to strategically condition when and how full harmonization in foreign and security policy with the EU must be secured.

- The EU and the US must prepare a strategy in the event that their conflict with Russia escalates to the point that a changed approach to Serbia is required. This must define the conditions under which Belgrade will be asked to join EU sanctions against Russia to keep its candidacy on track. This strategy should also include financial assistance to cushion the immediate economic effects of an enforced break by Belgrade with Russia, as well as integrating Serbia into the EU's plans on how to insulate the Union from a potential energy cut-off by Moscow.
- In the wake of the Ukraine crisis, the Union has finally begun to strategically *redefine* its energy policy, recognizing the need for a joint EU energy policy. This may well lead to changes in the *Acquis* in the years to come. The Union should thus consider keeping negotiations with candidate countries like Serbia on Chapter 15 (energy) open until the *completion* of the rest of the negotiation process. This would allow the negotiations to take future changes to the *Acquis* into account.
- The EU should strictly apply its competition and environmental protection rules to the South Stream pipeline project, as well as ensure that candidates fully harmonize with the Union's geopolitical interests. These have already been affected by the Ukraine conflict. The EU should give a green light to the pipeline project only if Russia shifts to a constructive policy in Ukraine and the violent conflict in the East of the country has been resolved.
- The timing is ideal for Serbia to diversify its energy sources and embark on a program that promotes energy efficiency and renewables. This development would free Serbia from its current unhealthy relationship with Russia based on economic-political dependency. The EU should offer assistance to wean Serbia from its dependency on Russian energy and modernize its energy sector. In this context, Brussels should encourage Belgrade to join the TAP-IAP project as a means to diversify its energy supply, and provide financial support for a Serbian pipeline branch.
- The European Commission should signal to Croatia that it would block the sale of MOL's shares in INA to Gazprom, as this would give Gazprom a near monopoly position in the Western Balkan oil production and refining sector. The EU and the US should support the Croatian Government's consideration of purchasing a majority stake back from MOL, offering financial support (such as loans on favorable terms) toward this strategic end.

## Introduction

This spring's crisis in Ukraine instantly changed the geopolitical reality in and beyond Europe. It has profoundly altered the relationship between the West and Russia. It has generated new urgency for a coherent and strong EU Common Foreign and Security Policy (CFSP), a goal that had been put on the back burner for half a decade due to the Euro crisis. Russia's actions have spurred long overdue serious debate about a future joint EU energy and enlargement policy. The Ukraine crisis highlights the urgency of a strategic EU Neighborhood Policy and enlargement policy

The new geopolitical reality represents a challenge first and foremost to Western unity. Russia's provocative actions revealed serious cracks both between the US and the EU and within the European Union, based on differing interests and variance in individual relationships with Russia. From the outset, Washington reacted more strongly and with more aggressive measures than the EU. But the US, in contrast to the EU and many of its most influential member states (like Germany), has a negligible trade exchange with Russia. Due to shale gas exploitation, the US is moving from being an energy importer to being an exporter. Many EU members, on the other hand, are completely or largely dependent on Russian gas supplies. Convincing countries like Hungary, Bulgaria and Slovakia that have a 100 percent dependency on Russian gas has proved especially difficult. But larger members with close economic ties to Russia, such as Germany, Britain, France and Italy, were also torn. Germany was finally forced by events – including the downing of Malaysian Airlines MH17 – in Ukraine to give up its remaining illusions in a possible revival of a “modernization partnership” with Russia and to jump-start a completely new Russia policy – at a point in time when Berlin had just begun discussing a redefinition of its foreign and security policy.

The Western Balkans region, which has in recent years largely moved towards EU membership has found itself on the margins of these developments, has not remained unaffected. The Balkan wars of the 1990s have become a reference point for the Crimea crisis, both in Russia and Crimea, but also in heightened public debates in the West.<sup>1</sup> At the same time, the Western Balkans has become the object of intensified Russian diplomatic and propaganda activities, an additional battlefield in the new geopolitical conflict between the West and Russia – a reminder of the 1990s.

This policy brief assesses the impact of the Ukraine crisis on Western policy in the Western Balkans. It analyzes the immediate effects of the conflict with Russia on the countries of the region as well as political reactions by key EU and US actors. It tries to draw conclusions on the mid- to long-term impact of the conflict between Russia and the West on EU and US policy towards the countries of the Western Balkan region.

## Russia's regional role/position before the Ukraine crisis

During the 1990s, Russia's role in the Balkans was determined by redefining its relationship with the

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<sup>1</sup> For example: Cyrill Stieger, “Ukraine und der Zerfall Jugoslawiens. Ein Blick in den Abgrund”, in: *Neue Zürcher Zeitung*, May 12, 2014; at: <http://www.nzz.ch/meinung/kommentare/ein-blick-in-den-abgrund-1.18300998>

West. At the same time, both sides in Russian-Serbian relations were colored by a nationalistic, mythical narrative of pan-Slavic brotherhood and that Russia was Serbia's protector. The Yeltsin regime first sought to navigate between aligning with the West and trying to mute its nationalist opposition by paying obeisance to Serb interests on the international stage. As this policy was designed for internal consumption and Russia had not defined any clear geopolitical interest in the Balkan region, Moscow's role came down to cooperating with the West while trying to soften Western policy towards Serbia and Serbs. As a consequence, Western efforts to placate Russian positions and include a then-democratizing Russia impeded conflict resolution. The West was successful in ending the bloody wars only when it adopted a united position and took decisive action under American (and in the Kosovo case, also British) leadership in 1995 and 1999. This approach ultimately sidelined Moscow.<sup>2</sup>

Russia's influence on **Serbia** sharply declined after the fall of the Milošević regime in October 2000. The new democratic government took a clear pro-Western course. It was only after 2004 that relations with Russia strengthened again<sup>3</sup> when Prime Minister Vojislav Koštunica revived Serb nationalism and anti-Western tones. His government asked Moscow for support to prevent recognition of Kosovo as an independent state in the UN while international negotiations were beginning over the final status of the former Serbian province. This policy was supported and continued by President Boris Tadić and his Democratic Party (DS)-led government after Koštunica's ouster and Kosovo's declaration of independence, both in 2008. Russia's policy under President Vladimir Putin, too, was not based on any elaborate geopolitical interest in the Balkans. Yet it secured good relations with Serbia – the only country in the region has so far not aimed for NATO membership. At the same time, Russian support for the resistance against Kosovo independence came with a high economic price for Serbia – an Agreement on Cooperation in Oil and Gas Enterprises signed between the two countries in 2008 (see section on energy below). As the West began to put an end to Tadić's straddling policy of "EU and Kosovo," and Belgrade started to move away from Kosovo and towards EU-integration – most markedly after German Chancellor Angela Merkel's Belgrade visit in August 2011, which followed the outbreak of violence in the Serb North of Kosovo – the relationship between the Tadić regime and Moscow seriously deteriorated. The former Russian Ambassador to Serbia, Aleksandr Konuzin, who was nicknamed "the Serb ambassador to Serbia" exclaimed in exasperation at the Belgrade Security Forum in September 2011 "are there any Serbs in this room?!" This became a famous expression of this Russian frustration with Serbia's westward turn.<sup>4</sup>

In summer 2012 Tadić and his DS-led ruling coalition lost presidential and parliamentary elections. Two parties which formed clearly identifiable elements of the 1990s Milošević regime – the Serbian Progressive Party (SNS) and the Serbian Socialist Party (SPS) – for the first time since 2000 jointly came to power, apparently creating conditions for a reset of Serbian-Russian relations. Ivica Dačić, the SPS party leader in 2012, on one of many visits to Moscow, publicly admitted Russian pressure on the SPS to

<sup>2</sup> Hoppe, Hans-Joachim, *Rußland und der Jugoslawienkonflikt*, Bundesinstitut für ostwissenschaftliche und internationale Studien, Köln 1997, p.4 ff.

<sup>3</sup> "Rusija i Srbija," *Helsinki Bilten* No.93, Helsinki Committee for Human Rights in Serbia, April 2013, p.2, 8-9.

<sup>4</sup> Ibid.; "Konuzin napustio Beogradski bezbednosni forum," *Večernje novosti*, September 15, 2011, at: <http://www.novosti.rs/vesti/naslovna/aktuelno.69.html:345310-Konuzin-napustio-Beogradski-bezbednosni-forum>



turn away from the DS and to form a government with the SNS.<sup>5</sup> Newly elected President Tomislav Nikolić, from the SNS, visited Moscow twice in 2012 to meet with Vladimir Putin. Yet these visits demonstrated that although the new government in Serbia was symbolically strengthening its traditional foreign policy ties with Russia, it would nevertheless continue to follow the EU integration course set by its predecessors.

This ultimately became clear during the EU-mediated dialogue with Kosovo in late 2012 – early 2013, which turned the West – and particularly the German government – into the Serbian Government’s dominant reference point in international policy. Though then-Prime Minister Dačić traveled to Moscow after the failed eighth round of dialogue in April 2013 (and before the ninth round that brought the breakthrough and the signing of the first agreement between Belgrade and Prishtina), the fact that Moscow was kept on the sidelines of political developments by Belgrade and only retroactively informed in the final negotiation stage demonstrated this marginalization of Russia in Serbian official politics. This remarkable policy shift on Kosovo by the formerly nationalist parties in Serbia removed the basis for Serbia’s political reliance and political dependency on Moscow.<sup>6</sup>

However, this decline in relations was accompanied by some bilateral agreements that appeared to represent an intensification of the existing relationship. In May 2013, during his visit to Putin at his summer resort in Sochi, Serbian President Nikolić signed a Declaration on Strategic Partnership between Serbia and Russia – 13 years and eight drafts after negotiations over such a document had initially started. Yet analysts in Serbia judge that this document is mostly of declarative, symbolic character and allude to similar declarations Russia signed with many, including many Western states.<sup>7</sup> In November 2013, Russian Defense Minister Sergei Shoigu during the first visit of a Russian defense minister to Serbia in 15 years signed a bilateral military cooperation agreement. Again – while some military experts were worried most analysts saw no serious military association with Russia emerging from the arrangement.<sup>8</sup> While the Dačić government extended cooperation on a joint Russian-Serbian disaster management center in the Southern Serbian city of Niš, both sides have repeatedly denied allegations that the center (established in 2011) is a cover for Russian espionage on the US’ anti-missile defense shield in Eastern Europe.<sup>9</sup>

<sup>5</sup> „Za sve postoji prećutna saglasnost Moskve i Vašingtona,” *Danas*, September 15, 2012.

<sup>6</sup> „Rusija i Srbija,” *Helsinški Bilten* No.93, April 2013, p.2-3.

<sup>7</sup> “Nikolić i Putin potpisali Deklaraciju o strateškom partnerstvu,” *Radio Free Europe*, May 24, 2013; at: <http://www.slobodnaevropa.org/content/nikolic-i-putin-potpisali-deklaraciju-o-strateskom-partnerstvu/24996484.html>

<sup>8</sup> The agreement includes trainings for Serbian junior officers in Russia, joint army exercises, the participation of a Serbian armored unit in a traditional Russian tank competition and closer cooperation of the two general staffs. Serbia has bilateral military cooperation agreements with over a dozen countries, many of them Western NATO member states. Serbia participates in NATO MAP program. On Serbian military experts’ varying assessments see: “Da li je Srbija u snažnom vojnom ruskom zagrljaju,” *Radio Free Europe*, November 13, 2013, page 4-5; at: <http://www.slobodnaevropa.org/content/stojadinovic-vojni-sporazum-srbije-i-rusije-ima-politicku-simboliku/25166808.html>; Jelena Milić, “Tužni Tok,” in: *Novi vek*, No.05, Belgrade November-December 2013, at: [http://www.ceas-serbia.org/root/prilozi/Novi\\_vek%20br-05-nov-dec%202013%20novo.pdf](http://www.ceas-serbia.org/root/prilozi/Novi_vek%20br-05-nov-dec%202013%20novo.pdf)

<sup>9</sup> “Humanitarni srpsko-ruski centar u Nišu nastavlja sa radom”, *Blic*, April 25, 2013,

Economic relations between Serbia and Russia have remained a consistently important factor. In 2011, the two countries confirmed a free trade agreement signed in 2000 between Russia and the then-Federal Republic of Yugoslavia. Serbia is to date the only non-CIS (Commonwealth of Independent States) member state that enjoys such a privilege. In the course of the country's EU accession process, Serbia will have to curtail its free trade regime with Russia, and economists question the real value to Serbia of the arrangement. While some insist Serbia has made limited use of the arrangement due to the low technical quality of Serbian products and due to the geographical distance, others point to the fact that the Russian Duma has never even ratified the agreement. Russia nevertheless remains an important trading partner for Serbia. In 2013, the overall trade volume between the countries was \$3.34 billion – a sharp rise compared to 2012. Russia is the third most important importing trading partner for Serbia and the fourth most important export destination. Yet Serbia's relationship suffers from a perennial trade deficit that constantly ranges between 60 to 80%. This is due to Russian energy imports that make up 57% of Serbian imports from Russia.<sup>10</sup>

**Montenegro**, much earlier and much more consistently shifted its geopolitical orientation towards the West. This began in 1997, when its long-term political leader, Milo Đukanović, broke ranks with Milošević's Serbia. Podgorica early on made clear its policy orientation for Euro-Atlantic integration, including NATO-membership. In 2013, the Montenegrin government consequently rejected a request by the Russian Navy for the use of the Montenegrin harbor of Bar as a potential alternative to the insecure Syrian port of Tartus. Podgorica has clearly alienated Moscow over the years with its aspiration to NATO-membership; the current Russian Ambassador to Belgrade has labeled Montenegro as "apishly" servile to the Alliance.<sup>11</sup> While political ties with Russia loosened, Montenegro's shady privatization process during the previous decade led to increased Russian influence in the economic sphere. Most prominent was the case of the Aluminum Combine Podgorica (KAP), which was privatized in 2005. Its majority shares were sold by the Montenegrin state far below its market value to an offshore company owned by Russian oligarch Oleg Deripaska. As in the socialist era, KAP's business was based on state-subsidized energy. When the public electricity company was forced after a few years to raise electricity prices closer to market levels, the business model collapsed. The Montenegrin state had to take the company into receivership, with huge uncovered state credit guarantees. Deripaska filed a commercial court case.

At the same time, 50% of tourists in Montenegro originate from Russia and Ukraine. 28% of them are not traditional tourists, but Russian tycoons who have bought up a substantial share of high-cost real estate along Montenegro's coast. While this economic factor is relatively stable, EU integration related reforms, especially in the rule of law, have in recent years led to Russian capital of suspicious origin

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at: <http://www.blic.rs/Vesti/Hronika/379714/Humanitarni-srpskoruski-centar-u-Nisu-nastavlja-sa-radom>;

"Šojgu: Rusija neće špijunirati Rumuniju iz baze u Nišu," *Blic*, October 17, 2011,

at: <http://www.blic.rs/Vesti/Drustvo/283730/Sojgu-Rusija-nece-spjunirati-Rumuniju-iz-baze-u-Nisu>

<sup>10</sup> Jasmina Simić, "Ekonomski aspekti strateškog partnerstva Srbije i Rusije," in: *Novi vek* No.6, Belgrade February 2014, p.22-23, at: [http://ceas-serbia.org/root/images/Novi\\_vek\\_br\\_06-J.Simic.pdf](http://ceas-serbia.org/root/images/Novi_vek_br_06-J.Simic.pdf)

<sup>11</sup> Podijeljene reakcije na optužbe Rusije protiv Đukanovića," *Radio Free Europe*, April 15, 2014, at: <http://www.slobodnaevropa.org/content/podijeljene-reakcije-na-optuzbe-rusije-protiv-Đukanovića-/25334106.html>

moving out of Montenegro. With an overall trade volume between Montenegro and Russia only €21 million in 2012, the small country's economic dependency on Russia has plummeted.<sup>12</sup>

In **Bosnia and Herzegovina (BiH)**, Russia has been a member of the PIC and its Steering Board since Dayton (as well as its precursor, the Contact Group). Through 2005, it was largely supportive of international efforts to drive reforms, according to those who participated in the then-weekly Peace Implementation Council's Steering Board (PIC SB) ambassadors' meetings, as well as political director-level meetings, which were then held quarterly.

However, Russia has developed a close relationship with Milorad Dodik over the past eight years, and has become increasingly vocal in the PIC SB and in public on his and his entity government's behalf, thereby weakening the reforms it once supported. This was not always readily apparent due to the dispersal of positions among the Western PIC members. Russia opportunistically exploited divisions among PIC SB members over the maintenance and application of the Dayton executive instruments – the High Representative and EUFOR – which prevented the West from coalescing around a common strategy.<sup>13</sup> Over time, Russia became increasingly vocal in defending the RS government from PIC SB opprobrium or actively pressing Dodik's agenda. One public manifestation of this was Ambassador Aleksandr Botsan-Kharchenko's statement that he was "happy" with the non-extension of international prosecutors and judges in for the Court of BiH's organized crime and corruption chamber, though he wished the war crimes personnel had only been extended for a year.<sup>14</sup> Dodik had threatened to withdraw RS representatives from the BiH government if any but appellate war crimes personnel were extended.

A visible element of this phenomenon can be viewed in the increasing number of footnotes denoting disagreement that Russia insists be included in PIC communiqués and declarations. But represented by the very capable Ambassador Botsan-Kharchenko, Russia also "weeded" the PIC SB statements quite thoroughly of elements viewed as problematic by Banja Luka, as well as often still insisting on footnotes at the end of the process.<sup>15</sup> An insistence by the EU and continental European PIC SB members on

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<sup>12</sup> "Rusi i Ukrajinci ipak stižu u crnogorska ljetovlišta," *Radio Free Europe*, April 10, 2014, at: <http://www.slobodnaevropa.org/content/rusi-i-ukrajinci-ipak-stizu-u-crnogorska-ljetovalista/25328523.html>; "Ratković: Moguće restrikcije dolazaka ruskih turista u Crnu Goru," *Radio Free Europe*, April 27, 2014, at: <http://www.slobodnaevropa.org/content/ratkovi%C4%87-mogu%C4%87e-restrikcije-dolazaka-ruskih-turista-u-crnu-goru/25363825.html>

<sup>13</sup> See Kurt Bassuener and Bodo Weber, "House of Cards: the EU's "reinforced presence in Bosnia and Herzegovina – Proposal for a new approach," Democratization Policy Council, May 1, 2013, p. 5., at: <http://www.democratizationpolicy.org/pdf/briefs/may.pdf>

<sup>14</sup> Statement of the PIC Steering Board Ambassadors, December 14, 2009, at: [http://www.ohr.int/pic/default.asp?content\\_id=44274](http://www.ohr.int/pic/default.asp?content_id=44274) Author present at press conference when Ambassador Botsan-Kharchenko made his statement. Contemporaneous e-mail account of proceedings sent by Kurt Bassuener to numerous US and diplomatic contacts: "Sellout without payoff: a disgraceful day for US diplomacy on Dayton's 14<sup>th</sup> anniversary," December 14, 2009 (available on request).

<sup>15</sup> Numerous discussions with SBA and PIC SB meeting participants, 2007-2014.

lowest-common denominator consensus<sup>16</sup> effectively abetted this Russian tactic.

According to communiqué drafting negotiation participants, in the PIC meeting in May 2014, Russia employed the same strategy, taking it to a higher level by objecting to what had hitherto been boilerplate regular pronouncements proclaiming support for BiH's sovereignty and territorial integrity.<sup>17</sup> However, as one interviewee present at the meeting put it, this time there was no *Russlandverstehen* (sympathetic indulgence of Russian positions) by Germany or other continental EU members who had previously demanded consensus, thereby increasing Russian leverage.<sup>18</sup> The language stayed in the document and Russia objected to it in its entirety.<sup>19</sup> Ambassador Botsan-Kharchenko later explained that Russia objected to including statements on BiH's sovereignty and territorial integrity without also including language on supporting entity competences and full equality among BiH's three constituent peoples.<sup>20</sup> Such language would have supported RS President Dodik's efforts toward further subdividing BiH, in collusion with HDZ leader Dragan Čović. Russia has been an effective opportunistic player in BiH by way of the PIC SB, enabled in its efforts due to the disunity of the West and its still undefined policy toward BiH.

### Implications of the Ukraine crisis

As with the rest of Europe, the Ukraine crisis caught the political leadership in **Serbia** unprepared. The fact that the annexation of Crimea by Russia was justified by President Putin with a reference to Kosovo's independence – in total contradiction with Russia's standing Serbia-Kosovo policy, but consistent with Moscow's unprincipled policy already seen in Georgia in 2008 – and that the Crimean declaration of independence also referred to Kosovo, gave Belgrade officials a serious headache. Reactions ranged between declaring Putin's statement a lapse to downplaying the whole affair. For several weeks, government officials in Belgrade hid behind the campaign for early elections on March 16 and the government formation process to avoid taking official positions. However, right after the elections Vučić and Dačić both visited Moscow at the same time for purported "medical treatment." Though most Serbian media did not report on the trip (it was never officially confirmed), this obviously presented a Russian attempt to convince the SNS leader to keep Moscow's traditional ally, the SPS, in government, despite the SNS' winning an absolute majority of seats in the Serbian parliament.<sup>21</sup>

When the new government finally entered office at the end of April, Prime Minister Vučić and his new Deputy Prime Minister and Foreign Minister Dačić declared that Serbia would pursue a "balanced approach" towards the Ukraine crisis and the conflict between the West and Russia. This straddle was

<sup>16</sup> The PIC SB is not formally a consensus body. If it were, statements would not have been issued with Russian (and later Turkish) footnotes in recent years. The insistence on consensus was a political decision.

<sup>17</sup> Discussions with PIC SB member state diplomats, May-July 2014

<sup>18</sup> Discussion with senior EU member state diplomat, May 2014.

<sup>19</sup> Communiqué of the PIC Steering Board, May 22, 2014 at: [http://www.ohr.int/pic/default.asp?content\\_id=48554](http://www.ohr.int/pic/default.asp?content_id=48554)

<sup>20</sup> Harčenko: Kao da osim suvereniteta BiH druga ništa ne važno," Poskok.info, May 23, 2014. at: <http://poskok.info/wp/?p=92776>

<sup>21</sup> "Vučić i Dačić u Moskvi?," *Radio Free Europe*, March 20, 2014, at: <http://www.slobodnaevropa.org/content/vucici-dacic-u-moskvi/25303845.html>

quickly labeled by domestic analysts and media as “and the EU and Russia” – Serbia would declaratively support territorial integrity of Ukraine, but at the same time not join Western sanctions against Russia in order not to risk its good relations with Moscow. At a press conference in May, Prime Minister Vučić defended this two-track policy in a rather blunt way, insisting “the Serbian government is protecting the interests of Serbia’s citizens... What policy do you think would be better? Do you want us to introduce sanctions against Russia, that we state that we support the breach of territorial integrity, whereby we would lose Kosovo, or to turn our back on the EU?”<sup>22</sup> Caught in this non- (or double-) alignment, Vučić and his colleagues were forced to adjust the geopolitical reality to their foreign policy approach. For example, the Prime Minister insisted that, “we won’t introduce sanctions against the Russian Federation because we would act against those that never introduced sanctions against Serbia.” This was baldly false. In the 1990s, Russia supported *all* Western-initiated energy, weapons, and trade sanctions against the Federal Republic of Yugoslavia (Serbia-Montenegro) in the UN Security Council, and also voted for Serbia-Montenegro’s exclusion from the CSCE in 1992.<sup>23</sup> At another press conference in Moscow at the beginning of July, Vučić noted that, “Serbia supports president Putin’s peace initiatives on Ukraine... Serbia also supported Germany’s position on this topic. Serbia wants a peaceful solution of the Ukrainian problem.”<sup>24</sup> This was another clumsy attempt to paper-over the profound differences between Russia and the West. Yet this attempted fudge has in the end always favored Russian policy. Serbia has not aligned with *any* of the various Ukraine declarations the EU has issued since the outbreak of the conflict, nor joined any of the initiatives EU member states launched at the OSCE. According to some experts, Serbia’s score on harmonizing its foreign policy with the EU’s has fallen from 90% to below 50%. When pressed on Chapter 31 of accession negotiations (on the CFSP), Foreign Minister Dačić and others have insisted that full harmonization is only demanded towards the *end* of the accession process.<sup>25</sup>

In contrast to the government’s attempt to characterize its policy as a “balanced approach,” the Serbian public has mostly taken a pro-Russian position. Most Serbian media at the beginning of the Crimea crisis shifted from relatively objective reporting on the Maidan protests to a pro-Russian, sometimes even gleeful view on developments in Ukraine. Only a small number of independent media maintained an objective line. Among citizens, too, pro-Russian attitudes seem to prevail. In opinion polls, Russia remains among the most favored countries for Serbian citizens. These attitudes are the result of a romantic image of a great Russia that can swoop in to help solve Serbia’s problems and of a mythical – and false – image of special Serbian-Russian relations that nonetheless has been nurtured for decades.<sup>26</sup>

<sup>22</sup> “Beograd o Ukrajini: Balansiranje između Brisela i Moskve,” March 24, 2014, at: <http://www.slobodnaevropa.org/content/beograd-o-ukrajini-balansiranje-izmedju-brisela-i-moskve/25308014.html>;

“Vučić: Srbija neće imati neprijateljski stav prema Rusiji,” *Radio Free Europe*, March 22, 2014, at: <http://www.blic.rs/Vesti/Politika/451761/Vucic-Srbija-neece-imati-neprijateljski-stav-prema-Rusiji>

<sup>23</sup> “Srbija uspešno balansira između Brisela i Moskve,” *Radio Free Europe*, April 1, 2014, at: <http://www.slobodnaevropa.org/content/srbija-uspesno-balansira-izmedju-brisela-i-moskve/25317170.html>

<sup>24</sup> “Vučić razgovarao s Medvedom,” *Politika*, Belgrade July 7, 2014, at: <http://www.politika.rs/rubrike/tema-dana/Vucic-razgovara-sa-Medvedevom.sr.html>

<sup>25</sup> Interviews with EU member state diplomats, June 2014. Serbian Foreign Minister Ivica Dačić in July insisted his country’s score is around 70 per cent.

<sup>26</sup> “Srbija: Ukrajina top tema u medijima,” *Radio Free Europe*, March 08. 2014,

The Russian state directly supports such attitudes with their own propaganda efforts. A Russian Internet news portal in the Serbian language, *FAKTI*, is increasingly serving as a news base for Serbian media on Ukraine and Russia. Its legal and ownership structures remain completely opaque, but the portal carries the logo of the Russian Embassy in Serbia at the top. Rumors about the Russian international TV station *Russia Today* (RT) entering the Serbian market have been supported by the Russian Ambassador's statements. Russian academics and representatives from Russian think-tanks occupy a prominent place in Serbian media, through which they spread the official Russian world view. This is particularly, but not exclusively, seen in the journal *Geopolitika* (Geopolitics), run by Milošević's former director of Serbian state television, Milorad Vučelić. Vučelić denies accusations that his journal receives Russian financial support. The most vocal of Russia's supporters can be found among the editors and authors of the academic journal *Nova Srpska Politička Misao* (New Serbian Political Thought), around which nationalist intellectuals assembled during the time of the Koštunica government.<sup>27</sup>

In addition, various NGOs and institutes of unclear organizational and financial background have popped-up in recent months underpinning Moscow's narrative on the Ukraine crisis and promoting the idea of Serbian integration into Russia's geopolitical Eurasian Union project. Some of these organizations are personally linked with the core of nationalist and ultranationalist academics who remain prevalent and influential among Serbia's intellectual elite.

The kind of schizophrenic diplomacy that Belgrade has pursued since May of this year has caused irritation among Serbia's Western partners. On May 6, the day when EU Enlargement Commissioner Stefan Füle was in Belgrade, the Chairman of the Russian State Duma, Sergey Narishkin, who had just been blacklisted by the US, also visited the Serbian capital. After being received by the Speaker of the Serbian parliament, Maja Gojković (SNS), he opened a conference co-organized the *Gorchakov Fund*, a Russian government-funded "non-government organization" on public diplomacy, and the hitherto unknown *Belgrade Center for Eurasian Studies*, financed by the Russian Embassy in Serbia. In his speech, he referred to the Ukraine crisis and spoke about "nazism that develops where there is no moral hygiene" and complained about an alleged "anti-Russian hysteria [that is] turning into pro-fascist propaganda."<sup>28</sup> On June 11, Prime Minister Vučić met with German Chancellor Merkel on a multi-day visit to Berlin, during which Vučić stated that relations with Germany had taken on a new quality. The same day, Serbian President Nikolić received the Belarusian President and dictator Aleksandr Lukashenko in Belgrade on an official state visit. While Nikolić insisted the visit had long been planned and that the EU had been informed about it, Prime Minister Vučić, when pressed by journalists what he would have told Chancellor Merkel had she asked him about the Lukashenko visit, admitted he would

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at: <http://www.slobodnaevropa.org/content/srbija-ukrajina-top-tema-u-medijima/25290300.html>;

Jelena Milić, "Putinov Orkestar," in: *Novi vek* No.7, Belgrade May 2014, page 6,

at: [http://ceas-serbia.org/root/images/Jelena\\_Milic\\_Putinov\\_Orkestar\\_11.pdf](http://ceas-serbia.org/root/images/Jelena_Milic_Putinov_Orkestar_11.pdf)

<sup>27</sup> Milić, Ibid.; Milić "Tužni Tok," in: *Novi vek* No.5, Belgrade May 2013, page 3-4,

at: [http://ceas-serbia.org/root/images/Novi\\_vek\\_br-05-nov-dec\\_2013-Jelena\\_Milic.pdf](http://ceas-serbia.org/root/images/Novi_vek_br-05-nov-dec_2013-Jelena_Milic.pdf)

<sup>28</sup> "Nariškin: Antiruska histerija je profašistička propaganda," *Blic*, May 6, 2014,

at: <http://www.blic.rs/Vesti/Politika/462939/Nariskin-Antiruska-histerija-je-profasisiticka-propaganda>

have remained without an explanation.<sup>29</sup>

On June 16, Russian Foreign Minister Sergei Lavrov came to Belgrade for a two-day visit, during which he met with the highest state officials. Russian Ambassador Chepurin insisted that Lavrov's first visit in three years presented "no ordinary visit." During a press conference after the meeting with his Russian counterpart, Serbian Foreign Minister Dačić stated that "relations with Russia are probably on the highest level in the last couple of decades... without UNSC support by Russia and China, Serbia's position on Kosovo-Metohija would be hopeless today." Lavrov, in turn, announced close cooperation and confirmed an intensification of diplomatic cooperation, especially during Serbia's upcoming OSCE term as Chairman in Office in 2015.<sup>30</sup> Already in March, a Russian army delegation visited Serbia and announced a future joint exercise of Serbian and Russian special forces units. Though the visit was not publicly linked to the current Ukraine crisis and the exercise will not take place soon, the announcement nevertheless provoked a controversy in the Serbian public, given the geopolitical circumstances.<sup>31</sup> Finally, following a second trip to Berlin with a high-level economic delegation on June 30, Prime Minister Vučić went on an official visit to Russia on July 7-8 where he met with the Russian government of Dimitri Medvedev and with President Putin. Vučić declared the trip a full success in defending Serbian economic interests and promoting Serbian-Russian economic cooperation and exchange (for more details, see the following section).<sup>32</sup>

In **Montenegro**, the Đukanović government was initially as non-committal as Serbia, but it soon fully aligned with the West and harmonized its foreign policy with that of the EU. This included adopting the EU's sanctions against Russia. This break with Montenegro's traditional pro-Russian foreign policy earned Đukanović sharp criticism and attacks from pro-Russian parts of the opposition ahead of local elections in May. The Serbian Orthodox Church in Montenegro accused the government of supporting fascism. Sharp reactions came from Moscow where the Russian Foreign Ministry in a press release expressed its disappointment with the Đukanović government and considered its policy as "hostile towards Russia." Russian media reported about alleged planned sanctions against Montenegro, such as ending the visa free regime for Montenegrins or suspending the free trade agreement, but such rumors were repudiated by the Russian Ambassador in Podgorica. The Montenegrin Foreign Ministry rejected Russian criticism and declared Montenegro's policy in line with the country's aspirations for Euro-Atlantic integration, and not as a move against its traditionally good relations with Russia.<sup>33</sup>

<sup>29</sup> "Lukašenko kod Nikolića: Provokativna diplomatija," *Radio Free Europe*, June 11, 2014, at: <http://www.slobodnaevropa.org/content/luka%C5%A1enko-kod-nikoli%C4%87a-provokativna-diplomatija/25418596.html>

<sup>30</sup> Dačić: Članstvo u EU ne znači udaljavanje od Rusije," *Blic*, June 17, 2014, at: <http://www.blic.rs/Vesti/Politika/474032/Dacic-Clanstvo-u-EU-ne-znaci-udaljavanje-od-Rusije>

<sup>31</sup> "Vježba specijalaca Srbije i Rusije: Vojna saradnja ili pokazivanje moći," *Radio Free Europe*, March 13, 2014, at: <http://www.slobodnaevropa.org/content/vezba-specijalaca-srbije-i-rusije-vojna-saradnja-ili-pokazivanje-moci/25296106.html>

<sup>32</sup> Vučić razgovarao s Medvedom," *Politika*, Belgrade July 7, 2014, at: <http://www.politika.rs/rubrike/tema-dana/Vucic-razgovara-sa-Medvedevom.sr.html>

<sup>33</sup> "Podijeljene reakcije na optužbe Rusije protiv Đukanovića," *RFE*, April 15, 2014, at: <http://www.slobodnaevropa.org/content/podijeljene-reakcije-na-optuzbe-rusije-protiv-Đukanovića-/25334106.html>;

During an April trip by Prime Minister Đukanović to the US, it became obvious that Montenegro's attitude towards the Ukraine crisis was not only in line with the country's generally consistent alignment with EU foreign policy, but also aimed at enhancing Podgorica's chances to become a NATO member ahead of the Alliance's September 2014 summit in Wales. In a speech he gave at the Atlantic Council in Washington, Đukanović linked the Ukraine conflict with the Balkans where "pro- and anti-NATO forces are clashing, too... we have to be additionally worried about the future and stability of the Western Balkans and the credibility of NATO." He went on, insisting that "the signals from Ukraine need to be interpreted in the right way and we need to courageously go for further expansion of the Euro-Atlantic zone of security, the first and foremost in the Balkans ... Montenegro could be one of the first next members and serve the alliance as an answer to Ukraine,"<sup>34</sup> thus openly signaling his intention to capitalize on the Ukraine crisis.

In **BiH**, the Republika Srpska – Russia relationship only deepened in the wake of the Russian seizure of Crimea. RS President Dodik publicly linked Crimea's independence referendum to one he had long mooted for RS to break away from BiH.<sup>35</sup> With Russian Ambassador Botsan-Kharchenko at his side in a press conference on March 18, Dodik characterized the Crimea referendum as an exercise in self-determination, a right that he said needed to be "rehabilitated."<sup>36</sup> Russia later expressed its gratitude to the RS for its role in impeding BiH's alignment with the joint EU policy position on Russia's annexation of Crimea. Sarajevo-based journalists wryly noted that Botsan-Kharchenko was almost never available for interviews, so often was he in Banja Luka.<sup>37</sup>

Of even greater concern was the RS Government's attempt to capitalize on the Crimea crisis outside the media. According to Western diplomatic sources, in March Dodik requested Belgrade's support for RS secession, claiming he had already received Russian backing. "This time Dodik really seemed willing to move from rhetoric to action," said one diplomat.<sup>38</sup> Then-Deputy Prime Minister Vučić apparently told

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„Rusija prijeti Crnoj Gori zbog domaće javnosti,” RFE, April 24, 2014, at: <http://www.slobodnaevropa.org/content/rusija-prijeti-crnoj-gori-zbog-domace-javnosti/25361345.html>;

„Đukanović odbacio tvrdnje Moskve da su njegove poruke antiruske,” RFE, April 25, 2014, at: <http://www.slobodnaevropa.org/content/djukanovic-odbacio-tvrdnje-moskve-da-su-njegove-poruke-antiruske/25362662.html>

<sup>34</sup> “Đukanović: Dešavanja iz Ukrajine protumačiti na pravi način,” *Vijesti*, April 9, 2014,

at: <http://www.vijesti.me/vijesti/dukanovic-desavanja-ukrajine-protumaciti-pravi-nacin-clanak-194436>

<sup>35</sup> See “Dodik: We are learning from Crimea's example,” *InSerbia*, March 23, 2014. At: <http://inserbia.info/today/2014/03/dodik-we-are-learning-from-crimeas-example/> See also Gianluca Mezzofiore, “Bosnia's Serb Republic Leader Threatens Crimea-Style Referendum,” *International Business Times*, April 29, 2014. At: <http://www.ibtimes.co.uk/bosnias-serb-republic-leader-threatens-crimea-style-referendum-1446615> See also Gordana Katana, “With an eye on Crimea, Bosnian Serb leader calls for confederation,” *Reuters*, April 1, 2014. At: <http://www.reuters.com/article/2014/04/01/us-bosniaherzegovina-serbs-idUSBREA3017420140401>

<sup>36</sup> “Congratulations to the People of Crimea on a Legal Referendum,” SRNA, March 18, 2014. At: <http://www.srna.rs/novosti/188331/congratulations-to-the-people-of-crimea-on-a-legal-referendum.htm> See also “Dodik: Čestitke narodu krimu na zakonitom referendum,” *Nezavisne Novine*, March 18, 2014. At: <http://www.nezavisne.com/novosti/bih/Dodik-Cestitke-narodu-Krima-na-zakonitom-referendumu-235953.html>

<sup>37</sup> Discussions with Sarajevo-based journalists, May-June 2014.

<sup>38</sup> Confirmed in separate discussions with several Western diplomats, July 2014.



Dodik to forget the idea.<sup>39</sup>

Another aspect of the RS-Russia relationship is financial. In April, Dodik announced that a deal was at hand for Russian commercial credits in the amounts of €70 million, to be followed by €200 million, allowing the RS to refuse the terms demanded by the International Monetary Fund (IMF) for a new Stand-By Arrangement.<sup>40</sup> The terms of the alleged Russian deal were never publicized, and it seems in the end that the deal didn't materialize. Because the following month, in the wake of catastrophic floods which hit the RS heavily, a visiting IMF delegation announced it had come to terms with both entity governments, including reforms on "improving tax collection and safeguarding the integrity of the financial system," which – if implemented – would allow special drawing rights amounting to approximately €190 million.<sup>41</sup> There has been little or no discussion of a Russian loan since.

Russia's increasingly strident position in the PIC Steering Board has led to fears that Moscow may veto an extension of the EU military mission in BiH, Operation Althea/EUFOR, which will come up for a vote in the UN Security Council in November. The EU assumed the Dayton Annex 1 enforcement role from NATO at the end of 2004; this Dayton-mandated role obliges the EU to maintain a "safe and secure environment" in BiH. Exacerbating the concerns is the RS Government's policy shift, reflected in its voluntary report to the UN Security Council in 2014 which for the first time calls for EUFOR's executive (peacekeeping) mandate to be phased-out.<sup>42</sup> This change in policy is likely coordinated with Moscow.

In short, Russia is amplifying its long-standing spoiler role in BiH, allied with the RS and aided and abetted by Western disunity. One indicator is that in the debate on High Representative Valentin Inzko's report to the Security Council, Russian Ambassador Churkin repeatedly raised the "Croat question" and called for an end to the Office of the High Representative.<sup>43</sup> He attributed February's protests to causes deeper than social and economic dissatisfaction, stating the "main reason" was "the absence of a balanced multi-ethnic policy at the federal level, ignoring the legitimate rights of Croats, and the failure to resolve ongoing tensions among the main Bosnian parties."<sup>44</sup> These positions are in complete alignment with Dodik's pronouncements.

<sup>39</sup> Ibid.

<sup>40</sup> Elvira Jukić, "Bosnian Serbs Seek Russian Loan to Replace IMF," *Balkan Insight*, April 3, 2014. Available at: [www.balkaninsight.com/en/article/russian-credit-to-replace-the-imf-in-republika-srpska](http://www.balkaninsight.com/en/article/russian-credit-to-replace-the-imf-in-republika-srpska)

<sup>41</sup> "Statement at the Conclusion of an IMF Mission to Bosnia and Herzegovina," Press Release No. 14/252, May 30, 2014. Available at: [www.imf.org/external/np/sec/pr/2014/pr14252.htm](http://www.imf.org/external/np/sec/pr/2014/pr14252.htm)

<sup>42</sup> "Republika Srpska's Eleventh Report to the UN Security Council," Government of Republika Srpska, May 5, 2014. Part V, Point #96 heading reads "The Security Council should end the application of Chapter VII, which has no factual or legal basis." Available at: <http://www.bihdaytonproject.com/?p=2586>

<sup>43</sup> 7176<sup>th</sup> Meeting of the UN Security Council, May 15, 2014, pages 5-6. Debate transcript available at: [http://www.securitycouncilreport.org/atf/cf/%7B65BFCF9B-6D27-4E9C-8CD3-CF6E4FF96FF9%7D/s\\_pv\\_7176.pdf](http://www.securitycouncilreport.org/atf/cf/%7B65BFCF9B-6D27-4E9C-8CD3-CF6E4FF96FF9%7D/s_pv_7176.pdf); Conversation with EU member state diplomat, July 2014. Dodik has regularly voiced his support for a third, Croat, entity. See "Dodik za treći entitet u BiH," *Tanjug*, September 17, 2012. Available at: [http://www.rtv.rs/sr\\_lat/region/dodik-za-treci-entitet-u-bih\\_342422.html](http://www.rtv.rs/sr_lat/region/dodik-za-treci-entitet-u-bih_342422.html) He did this most recently at a meeting with HDZ BiH leader Dragan Čović. See "Dodik: Mi ćemo podržati da Hrvati imaju svoj entitet," *Herzegovina.info*, July 31, 2014 available at <http://www.herzegovina.info/vijesti/vijesti/politika/dodik-mi-cemo-podrzati-hrvate-da-imaju-svoj-entitet-77996>

<sup>44</sup> Ibid.

## Energy policy and geopolitics

Russia has traditionally played an important role in the energy sector of the Western Balkan countries as the main supplier of gas and oil. In addition, Russian influence has risen over the last decade and a half, as Russian companies have been among the main beneficiaries of the privatization of public energy companies in the region, often under legally questionable conditions.<sup>45</sup> As the Western Balkan countries have assigned a prominent role to gas in their plans to modernize their energy sectors and their economies as a whole, the role of Russia in the gas sector has received special attention in public and political discussion on the implications of the Ukraine crisis. This is underpinned by two realities. Russia has repeatedly demonstrated close linkage between foreign policy and the business performance of its main energy companies. The EU, prodded by the US administration and commentators in the media<sup>46</sup> has reacted to the Ukraine crisis by emphasizing the need to reduce its dependence on Russian gas.

**Serbia** covers only about a fifth of its current oil and gas needs from domestic sources. It is dependent on exports of Russian oil and even more so on Russian gas. It is exclusively supplied by *Gazprom* via Serbia's only pipeline-connection, which runs through Ukraine and Hungary to Serbia.

The current level of dependency on Russian energy is the price paid for Russia's political support for Serbia's fight against Kosovo's independence during the governing of Koštunica and Tadić, embodied in the 2008 bilateral *Agreement on Cooperation in Oil and Gas Enterprises*. The agreement contained three elements: 1) the inclusion of Serbia in the planned Russian South Stream pipeline project, which is to run under the Black Sea to Bulgaria via Serbia to central Europe; 2) the construction of Serbia's first (underground) gas storage facility, Banatski Dvor; and 3) the sale of the majority share of Serbia's monopoly public oil company NIS (*Naftna Industrija Srbije – Oil Industry of Serbia*) to *Gazprom*. The agreement was problematic both in relation to various domestic Serbian laws, including the constitution. The agreement foresaw the immediate sale of NIS, while the construction of South Stream through Serbia – the part of the deal which was potentially beneficial – has no legally binding character. While NIS was privatized, the agreement contains no deadlines for South Stream, nor has any commercial agreement been signed. A feasibility study has not even been conducted.<sup>47</sup>

The privatization of NIS ended the post-socialist practice of leaving strategic industrial sectors unmodernized and under-invested while high state subsidies disappeared into corrupt channels. Yet the sale of its majority shares (59%) to *Gazprom* proceeded under questionable legal and commercial circumstances. The Serbian government at the time ignored a privatization strategy developed by a Western consultancy company it had just inherited, and sold the shares to *Gazprom* without a tender,

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<sup>45</sup> David Clark/ Andrew Foxall, *Russia's role in the Balkans – Cause for Concern?*, The Henry Jackson Society, London June 2014, p.7.

<sup>46</sup> Michael Haltzel, *Resetting the Reset*, Huffington Post, March 3, 2014.

At: [http://www.huffingtonpost.com/michael-haltzel/resetting-the-reset\\_b\\_4890730.html](http://www.huffingtonpost.com/michael-haltzel/resetting-the-reset_b_4890730.html)

<sup>47</sup> Vladimir Medović, *Južni tok: posao veka ili parnica veka?*, Evropski pokret Srbija, Belgrade June 2014, p.8-9; ISAC, *Pravna analiz aranžmana između Srbije i Rusije u oblasti naftne i gasne privrede*, Belgrade December 21, 2009; Zorana Z. Mihajlović, "Serbian Energy Sector – Status and Contemporary Russian-Serbian Relations," in: ISAC Fund, *Russia Serbia Relations at the Beginning of XXI Century*, Belgrade 2010, p.159-161.

well below the estimated market value.<sup>48</sup> Breaching a set of domestic laws, Belgrade sold-off a company which holds an effective monopoly on exploitation and production of domestic oil (and to a lesser extent, gas). In addition, by granting a 3% exploitation tax to NIS, far below international standards (the tax in Russia is 22%, in some countries it is as high as 30%) and by exempting the company from future tax increases the Serbian state abandoned potential future revenues resulting from the modernization of NIS. Put another way, Belgrade handed over large parts of the future net benefit from privatization to the company close to the Kremlin.<sup>49</sup>

Under the agreement a 423 km segment of the South Stream pipeline would run through Serbia – an investment project said to be worth €1.9 billion Euros that would allegedly employ 100,000 workers on construction and produce an annual €200 million for Serbia from transit fees. The expansion of Russian gas imports from currently around 2 million m<sup>3</sup> to 5 million m<sup>3</sup> would serve as the basis for a systematic gasification of Serbia's industry and households. The framework's commercial conditions define the preferential treatment of *Gazprom* in several aspects. It is similar to agreements with the six EU member states (Austria, Bulgaria, Croatia, Hungary, Italy and Slovenia) *Gazprom*/Russia has signed. A joint company established by *Gazprom* and Serbia's public gas transportation company, *Srbijagas*, will own and run the pipeline. It will have the exclusive authority to determine gas transportation fees; *Gazprom* is granted the exclusive right to use the pipeline for 25 years; and Serbian and Russian companies will enjoy preferential treatment in the tender for the pipeline construction and companies from the both countries that participate in the South Stream project are granted tax privileges. In contrast to the contracts with EU member states, only in Serbia does *Gazprom* hold a majority 51% share of the joint company that operates South Stream.<sup>50</sup>

As is the case with the six member states, the South Stream agreement from the very beginning brought Serbia into conflict with the European Commission's efforts to create market conditions for the energy sector in Europe – via the Energy Community, which Serbia joined in 2007. The Energy Community expands the EU's *Acquis* in the energy sector to the (non-EU member) countries of the Western Balkans. The South Stream arrangements are in breach of the conditions of the EU's Second Energy Package for the gas sector, which demands: 1) the legal and functional separation of production and transportation, supply, and distribution; 2) free access of third parties to transport and storage facilities; and 3) the existence of an independent domestic state regulatory agency with authority to determine gas prices. With the third Energy Package, adopted by the Energy Community in 2011, the EU sets an even tighter condition of separation of ownership between gas transportation and production. From an international law perspective, Serbia's bilateral agreement with Russia has supremacy over its

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<sup>48</sup> Taking into account the 500 Million Euro that *Gazprom* has invested in modernizing NIS facilities the price still remains below the estimated value of the company. Mihajlović, *Ibid.*, p.155; Bojan Lađevac, *Russland und Serbien: eine neue Ära der Beziehungen?*, Friedrich Ebert Foundation, Berlin, November 2012, p.3.

<sup>49</sup> Domestic production of oil covers about 20% of the overall consumption, while the domestic gas production varies between 10 and 20% of overall gas needs. Mihajlović, *Ibid.*, p.160; Mijat Lakićević, “Tužni tok,” June 2009 and “Pozamljuju li nam Rusi naše par,” June 2014, at: <http://www.mijatlakicevic.com/category/blog/>

<sup>50</sup> Medović, *Južni tok: posao veka ili parnica veka?*, p.9; “Južni tok u Srbiji: Biti ili ne biti,” RFE, April 15, 2014, at: <http://www.slobodnaevropa.org/content/ju%C5%BEEni-tok-u-srbiji-bit-i-ili-ne-bit-i/25334337.html>

obligations as an Energy Community member. Yet in the framework of its accession to the EU, Serbia is obliged to harmonize its energy sector with the *Acquis* – including Chapter 15, which covers energy issues. Serbia is obliged to amend all international agreements that are in collision with the *Acquis*. Serbia, just as all EU states participating in the South Stream project and Russia, consistently ignored Commission objections and also did not make use of the possibilities to request an exemption from certain Energy Package regulations. Instead, in November 2013 Bulgaria and Serbia held symbolic “first welding”-ceremonies to mark the beginning of the pipeline construction. As a consequence, in December the Commission asked the participating European states to change their agreements with Russia so they were compliant with EU rules and regulations. In January 2014, a first round of negotiations with Russia over the adjustment of the contracts took place.<sup>51</sup>

European energy experts question the economic rationale of South Stream, asserting that the primary goal is providing Russia with an avenue to circumvent Ukraine in its gas supply routes to European customers further west.<sup>52</sup> In 2009, a political and commercial conflict with Ukraine led to the interruption of Russian gas supplies to Europe. Consequently, following the outbreak of the Ukraine crisis the European Commission put negotiations on South Stream on hold. In June, the Commission forced Bulgaria to stop construction activities until the conflict over the renegotiation of agreements is solved. The Commission declared South Stream to be outside its portfolio of strategic energy projects. In Belgrade, Prime Minister Vučić reacted to the Bulgarian construction halt by pretending this had no effect on Serbia’s activities. But after a week, Vučić had to concede to reality and the Serbian government decided to basically put future construction of the pipeline through Serbia on hold.<sup>53</sup> In April, in the context of the new government’s formation, Vučić shuffled his SNS cabinet colleague Zorana Mihajlović from the Ministry of Energy to another ministry. Mihajlović, an energy expert, had demonstrated a critical stance on South Stream and other energy policy issues, drawing criticism from Russia and the SPS (which heads most of the public, non-privatized energy companies).<sup>54</sup>

On July 7-8, Prime Minister Vučić headed a government delegation to Moscow. The reported aim was resolution of outstanding economic issues with Russia. At a press conference following a meeting with his Russian counterpart, Dimitri Medvedev, and several ministers Vučić triumphantly declared that “all questions are solved... Serbia had four requests, the Russian side met us halfway on all these issues.” Yet Vučić refused to identify what these four requests had been. On South Stream he explained that “only technical details remain to be agreed.” Construction would begin at the end of 2014, with the first gas

<sup>51</sup> Medović, *Ibid.*, p.10-21; “South Stream bilateral deals breach EU law, Commission says,” *EurActiv*, December 4, 2013, at: <http://www.euractiv.com/energy/commission-south-stream-agreemen-news-532120>

<sup>52</sup> Julian Wieczorkiewicz/Arno Behrens, *On Ukraine Gas Transit and South Stream*, CEPS Commentary, Brussels March 21, 2014, at: <http://www.ceps.eu/book/ukrainian-gas-transit-and-south-stream-there-may-be-more-meets-eye>

<sup>53</sup> “Kad presuši Južni tok”, *Peščanik*, June , 2014, at: <http://pescanik.net/2014/06/kad-presusi-juzni-potok/>; “Srbija ne žuri sa odlukom o Južnom toku,” RFE, June 9, 2014, at: <http://www.slobodnaevropa.org/content/srbija-ne-žuri-sa-odlukom-o-južnom-toku/25415791.html>

<sup>54</sup> “Zorana Mihajlović: Ne brinite, ići ću u Moskvu uskoro,” *Blic*, November 14, 2013, at: [http://www.blic.rs/Vesti/Tema-Dana/419759/Zorana-Mihajlovic-Ne-brinite-ici-cu-u-Moskvu-uskoro](http://www.blic.rs/Vesti/Tema-Dana/419759/Zorana-Mihajlovic-Ne-brinite-ici-cu-u-Moskvu-uskoro;); “Ministarka nepoželjna na otvaranju Južnog toka,” *Blic*, November 22, 2013, at: <http://www.blic.rs/Vesti/Ekonomija/421752/Ministarka-nepozeljna-na-otvaranju-Juznog-toka>

supplied through the pipeline in 2016. Vučić announced on the second day of his visit that representatives from *Gazprom* and *Srbijagas* had signed a commercial contract on South Stream in Belgrade. The deal includes a €700 million credit from *Gazprom* to Serbia, which has no money to finance its part of the huge investment project, to be paid back from the pipeline income collected in the years following the completion of the construction. Vučić celebrated a protection clause that guarantees that Serbian companies will be sub-contracted for 50 % of the construction work as the result of his diplomatic efforts. Yet it emerged that a *Gazprom* subsidiary, *Centra Gas*, had won the tender on execution of the South Stream construction works.<sup>55</sup>

Contrary to Vučić's grandiose statements, the Prime Minister had remediated none of Serbia's structural problems in its economic relations with Russia. Nothing has been agreed in relation to the conflict with the EU over South Stream. The signed commercial contract includes no change to the originally agreed ownership and management structure of the joint company. Nor did Russia cede ground on the exploitative 3% revenue concession to NIS. The issue of a €300 million debt accumulated by several inefficient, non-privatized and *de facto* bankrupt Serbian industrial companies remained unsolved. Vučić's request to extend the Serbian-Russian free trade agreement to more products also remained unmet. Vučić announced Serbia would finally use a \$800 million Russian credit to modernize the Serbian railway. The credit is part of a 2008 \$1 billion loan which included \$200 million for stabilization of Serbia's budget in 2009. This will almost certainly reinforce Serbia's economic dependency on Russia.<sup>56</sup> Privatization of the public electricity company *Elektroprivreda Srbija* (EPS) is another topic which the Serbian media had assumed would be part of Vučić's consultations in Russia. Yet he has divulged nothing thus far on this topic. A Russian company is reported to have a long-standing interest in buying EPS, which for years has operated at a substantial loss. Recent unconfirmed rumors allege the German energy company RWE also has an interest in the sale. Should EPS be sold to a Russian (state-controlled or aligned) firm, this would cement almost complete Russian control over the Serbian energy sector.<sup>57</sup>

In **Bosnia and Herzegovina** (BiH), RS President Dodik has for years used energy policy as a means in his fight to undermine the state, affecting the state's institutional functionality as well as economic prosperity. This policy is based on close cooperation with Russian energy companies, resulting in a high level of economic dependency. In 2007, the RS Government headed by then-Prime Minister Dodik sold a set of three public oil companies to the Russian state-owned company *Zarubezhneft*. It included BiH's only oil refinery in Brod as well as the only motor oil plant in Modriča, plus a chain of gas stations with a one-third market share in that entity. The privatization took place under legally and commercially

<sup>55</sup> "Putin do kraja godine u Beogradu," *Politika*, July 8, 2014, at: <http://www.politika.rs/rubrike/tema-dana/Putin-s-Vucicem-Nameravamo-da-ojacamo-odnose-sa-Srbijom.lt.html>

<sup>56</sup> Conversation with Serbian journalist, July 2014; "Srbija, Rusija I EU: Problemi s Južnim tokom još nisu rešeni," *RFE*, July 9, 2014, at: <http://www.slobodnaevropa.org/content/srbija-rusija-i-eu-problemi-s-juznim-tokom-jos-nisu-reseni/25451485.html>; "Putin rekao 'njet' za 'fijat' iz Kragujevca," *Blic*, July 10, 2014, at: <http://www.blic.rs/Vesti/Politika/479593/Putin-rekao-njet-za-fijat-iz-Kragujevca>

<sup>57</sup> "Privatizacioni derbi: Rusi I Nemci u trci za EPS," *Danas*, 17 June 2014, at: [http://www.danas.rs/danasrs/ekonomija/privatizacioni\\_derbi\\_rusi\\_i\\_nemci\\_u\\_trci\\_za\\_eps.4.html?news\\_id=283674](http://www.danas.rs/danasrs/ekonomija/privatizacioni_derbi_rusi_i_nemci_u_trci_za_eps.4.html?news_id=283674)

dubious conditions (the contract was declared “top secret” by the entity government).<sup>58</sup> At the same time, the entity’s authorities unilaterally pursued a bilateral agreement with Russia on the construction of a branch of the South Stream pipeline from Serbia to BiH, though state-level institutions have a constitutionally defined role in any international projects.

Bosnia and Herzegovina has no domestic gas sources and is currently completely dependent on Russian gas supplied by *Gazprom* via Ukraine, Hungary and Serbia. Its pipeline is 192 kilometers long, divided up between the RS and the Federation of BiH and operated by separate entity-level companies. At less than 300 million m<sup>3</sup>/year, the annual gas consumption is quite low, far below the pre-war 1 billion m<sup>3</sup> (when gas was serving a functioning industrial base in BiH). Competences over the gas sector primarily lie with the entities. The central state, in particular the Ministry for Foreign Trade and Economic Relations (MOFTER), is responsible for harmonization of legal regulations and for the development of a joint energy policy. However, such coordination has failed, and there is no regulatory framework for gas in place at the state-level due to RS resistance.<sup>59</sup>

BiH is a member of the Energy Community. The Energy Community’s Secretariat has demanded that BiH establish a state regulatory framework based on “strong national capacities.” It should include a state gas law and a state gas regulatory agency in charge of the creation of a common gas market, licensing and approval of price tariffs. As Banja Luka has resisted such reforms for many years, the country remains in breach of the Second Energy Package, not to speak of the Third Package, and is therefore threatened with sanctions.<sup>60</sup>

Dodik and his government have long pursued an agreement with Moscow on South Stream. In 2012, the RS and *Gazprom* signed a MoU, and in June 2013 *Gazprom* and Gas-RESA, the public company established by the RS government for the pipeline project, signed a roadmap. The agreements determine a commercial deal as well as an ownership and management structure of the joint *Gazprom*-Gas-RESA company that includes all of the structural problems that are included in Serbia’s South Stream deal. In addition, the deal foresees a unique 60% *Gazprom* share in the joint enterprise. Moreover, the whole project foresees a totally unrealistic 20-fold rise of RS gas consumption from the current 100 million m<sup>3</sup> to 2 billion m<sup>3</sup> in 2025.<sup>61</sup> As was previously the case with previous inter-state

<sup>58</sup> “Privatizacija rafinerije – netransparentnost I opasan posao,” Transparency International BiH, Banja Luka December 14, 2007, at: [http://ti-bih.org/1526/Privatizacija\\_rafinerije\\_netransparentna\\_i\\_opasan\\_posao/](http://ti-bih.org/1526/Privatizacija_rafinerije_netransparentna_i_opasan_posao/); [http://www.zarubezhneft.ru/en/about\\_company/structure/](http://www.zarubezhneft.ru/en/about_company/structure/); <http://www.rafinerija.com/onama.html>

<sup>59</sup> *Bosnia-Herzegovina Energy Sector Country Profile*, EBRD, London 2009, at: <http://www.ebrd.com/downloads/legal/irc/countries/bosnia.pdf>; <http://www.mvteo.gov.ba/default.aspx?pageIndex=1&langTag=en-US>

<sup>60</sup> *Letter of Energy Community Secretariat Director Janez Kopač to BiH Foreign Minister Zlatko Lagumdžija, incl. Concept paper for a state level gas law in BiH*, Vienna May 23, 2014; Energy Community Secretariat 2013 Annual Implementation Report, Vienna September 1, 2013, p.206-207; “Kovačević: Zakon o gasu – samo zbir dva entitetska zakona,” *Nezavisne Novine*, January 31, 2014, at: <http://www.nezavisne.com/novosti/bih/Kovacevic-Zakon-o-gasu-BiH-samo-zbir-dva-entitetskih-zakona-229005.html>

<sup>61</sup> “BiH usred 'rata' EU i Rusije,” *Dnevni Avaz*, December 14, 2013, at: <http://www.avaz.ba/vijesti/teme/bih-usred-rata-eu-i-rusije>; “Izmirenje dugova preduslov za izgradnju Južnog toka kroz RS” *Nezavisne Novine*, November 26,

energy investment projects in hydropower,<sup>62</sup> the RS leadership usurped state competences and ignored the other entity, to the likely future detriment of the country as a whole.

After sealing the deal with Moscow, Banja Luka “generously” offered the extension of the pipeline project to the Federation, unilaterally prepared a draft bilateral agreement between Russia and Bosnia and Herzegovina and sent it to the BiH Council of Ministers in January 2014 for approval *post hoc*.<sup>63</sup> The Energy Community Secretariat objected to the draft agreement’s regulations, based on breaches to the Second and Third Energy Packages. It had done the same with the other European countries’ agreements, with the same rationale. Based on the Secretariat’s opinion, the Federation Government refused to participate in the project and resisted state-level approval of the bilateral agreement. The FBiH’s refusal noted that it contravened BiH’s obligation as a member of the Energy Community, also asserting that it would not contribute to the expansion of the gas market, integration into the regional market, or the diversification of energy sources. Consequently, it declared South Stream to be of “no strategic importance for the Federation.” Instead, the Federation government plans to participate in the alternative TAP-IAP (Trans-Adriatic Pipeline-Ionian-Adriatic Pipeline) project, which will transport Azeri gas from the Caspian Sea to Europe via Turkey, with a branch running along the Adriatic coast.<sup>64</sup>

The newest EU member state from the Western Balkans, **Croatia**, is much less threatened by energy dependency on external suppliers – including Russia – than its neighbors. Croatia currently covers 70% of its gas consumption and 15% of its oil needs from domestic sources. Almost all its imported gas comes from Italy. Croatia is also starting to explore assumed additional natural gas reserves both in the Adriatic and in Slavonia, which could potentially enlarge the share of domestic production. In addition, Croatia is planning to further diversify its international gas supply. The country is planned to be part of the TAP-IAP pipeline project. Zagreb originally rejected President Putin’s offer to run the South Stream pipeline via Croatia. It later agreed to have a branch run to Croatia, but is currently waiting for the EU and Russia to solve their dispute before entering into a contractual relationship. The Croatian government seems to have currently intensified planning on another long-discussed project: the construction of a liquid natural gas (LNG) terminal on the island of Krk. This project, which would turn Croatia into a regional gas hub, is among those included by the European Commission in its list of priority energy projects – however, it remains unclear who will invest in this strategically important

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2013, at: <http://www.nezavisne.com/posao/privreda/Izmirenje-dugova-preduslov-za-izgradnju-Juznog-toka-kroz-RS-219646.html>; “Južni tok i TE Ugljevik 3 – najznačajniji energetske projekti,” *ENERGETIKARS*, March 10, 2014, at: <http://energetikars.com/gas/juzni-tok-i-te-ugljevnik-3-najznacajniji-energetski-projekti>

<sup>62</sup> Kurt Bassuener/Bodo Weber, *Croatian and Serbian policy in Bosnia-Herzegovina: Help or hindrance?*, DPC Policy Study, October 2012, p.23, at: [http://democratizationpolicy.org/uiimages/pdf/dpc\\_neighbors\\_study\\_final.pdf](http://democratizationpolicy.org/uiimages/pdf/dpc_neighbors_study_final.pdf)

<sup>63</sup> “BiH usred ‘rata’ EU i Rusije”, *Dnevni Avaz*, December 14, 2013, at: <http://www.avaz.ba/vijesti teme/bih-usred-rata-eu-i-rusije>

<sup>64</sup> “EU upozorava BiH zbog ‘Južnog toka,’” *Dnevni Avaz*, January 19, 2014, at: <http://www.avaz.ba/vijesti teme/eu-upozorava-bih-zbog-juznog-toka>; “Dobro je da BiH ne razmatra ‘Južni tok,’” *Dnevni Avaz*, June 10, 2014, at: <http://www.avaz.ba/vijesti teme/dobro-je-da-bih-ne-razmatra-juzni-tok>; “Lagumdžija minira Južni tok,” *Glas Srpske*, May 18, 2013, at: <http://www.glassrpske.com/novosti/vijesti dana/Lagumdžija-minira-Juzni-tok/lat/119162.html>; “Informacija o Sporazumu između Vlade Ruske Federacije i Savjeta Ministara BiH o saradnji u oblasti gasa i elektroenergetike u cilju realizacije gasnog projekta “Južni tok,” Federation of BiH Ministry of Energy, Mining and Industry, Sarajevo June 2014.

project.<sup>65</sup>

However, Russian energy companies could yet seize a dominant position in Croatia domestic oil production. Croatia's national energy company, INA (*Industrija Nafta* – Oil Industry), recently appeared on *Gazprom's* Western Balkans shopping list. INA holds a monopoly over domestic oil, and even more importantly, over Croatian gas production. However, 49.1% of the company's shares were sold to the Hungarian company MOL during Ivo Sanader's term as Prime Minister. Sanader was recently convicted by a Croatian court for illegally handing over INA's management authority to MOL for a €5 million bribe. The Croatian Government still holds 44.8 % of the company's shares, and is negotiating with MOL to regain management control. Zagreb alleges that INA has regressed under MOL's management. Under such pressure, MOL is thinking about selling its shares. Recently, *Gazprom* declared interest in acquiring a majority share of the company, in addition to Rosneft's longer-standing bid. Gaining control over INA would give *Gazprom* a dominant regional position in oil production throughout the Western Balkans. In July, Croatian Economy Minister Ivan Vrdoljak raised the possibility for the first time that Croatia might buy out MOL in order to take back majority control. Yet given Croatia's current economic doldrums – six years of negative growth – and budget deficit, it remains to be seen how the Zagreb government could finance such a large investment.<sup>66</sup>

### EU-US reactions to the new challenge

Confronted with a profoundly altered geopolitical situation, the EU has been and still is fully occupied with handling the Ukraine crisis and the intensifying resultant frictions with Russia, leaving only limited time to deal with its impact on the Western Balkans. Differences in approach toward Russia among Western powers on display during the Ukraine crisis have only partly been reflected in Western policy in the Balkans. In countries like Serbia, where key actors like Berlin, London and Washington have in recent years coalesced around a joint policy in the Serbia-Kosovo dialogue, Western reactions have largely remained harmonized. In others, like Bosnia and Herzegovina, where a coherent common policy has long been lacking, reactions have mirrored these internal divisions.

On **Serbia**, the European Union has taken a “middle road” on the government's irritating “the EU and Russia” policy reaction to the crisis. This European policy gives Serbia some leeway in its alignment with EU policy. This policy is clearly espoused by Germany, Serbia's main partner within the EU since the beginning of the Kosovo-Serbia political dialogue in 2012. Berlin's dominant position and policy approach was clearly on display during Prime Minister Vučić's two extensive visits to the German capital

<sup>65</sup> *Energy Community Secretariat 2013 Annual Implementation Report*; “Dekanić: Hrvatski interes je postati energetska čvorište,” *RFE*, July 03, 2014, at: <http://www.slobodnaevropa.org/content/dekanić-hrvatski-interes-povećati-proizvodnju-i-postati-energetsko-cvoriste/25443441.html>

<sup>66</sup> “Rusi dolaze: Putinov Gazprom traži Inu od Orbana,” *Večernji list*, December 13, 2013, at: <http://www.vecernji.hr/gospodarstvo/ruski-gazprom-zeli-preuzeti-inu-od-mol-a-908871>; “Amerikanci otišli, Rusi stižu.” *RFE*, July 2, 2014, at: <http://www.slobodnaevropa.org/content/amerikanci-otisli-rusi-stizu/25443268.html>; “Croatia eyes loan to buy back INA from Hungary's MOL – minister,” *Portfolio.hu*, July 23, 2014, at: [http://www.portfolio.hu/en/equity/croatia\\_eyes\\_loan\\_to\\_buy\\_back\\_ina\\_from\\_hungarys\\_mol\\_minister.28124.html](http://www.portfolio.hu/en/equity/croatia_eyes_loan_to_buy_back_ina_from_hungarys_mol_minister.28124.html)



since the outbreak of the Ukraine crisis.<sup>67</sup> The German policy line on Belgrade is supported by Great Britain and other important EU member states that have driven the Union's Serbia policy in recent years. There are slight nuances however. British diplomats, for example, have employed stronger language in public statements on Serbian diplomacy's balancing approach.<sup>68</sup> The US has generally taken a tougher position on Russia than the EU, expressing concern about the possible impact of the crisis on the Western Balkan countries. But it has not engaged in any policy actions distinctively different from that of the EU in the Balkan theater.<sup>69</sup>

The EU accepted Serbia's abstinence from sanctions against Russia. But as a result of its policy, Serbia's score of harmonizing its foreign policy with that of the Union has fallen. The German Government respects "Serbia's historical, cultural and economic ties with Russia, and we have been reassured by Belgrade that its strategic decision on basic foreign policy orientation – EU integration remains unquestioned," as one diplomat put it. The policy approach seems to also be the result of weighing the Russia factor against other policy challenges the EU faces with Serbia, such as the revival of the currently *de facto* suspended dialogue process with Kosovo and the Vučić government's struggle with undertaking serious, unpopular structural economic reforms amidst looming national insolvency aggravated by the catastrophic May floods.

Subsequently, German diplomacy seems to have accepted Belgrade's argument that the accession process demands only *gradual* movement towards full harmonization of its foreign policy the EU's along the way to full accession. The lack of a common strong position on Russia within the EU has been pointed out by Belgrade; Berlin and others have indulged this. The EU also seems willing to attribute Serbia's double-track diplomacy to a division of work between Prime Minister Vučić and President Nikolić aimed at paying respect to domestic nationalist and pro-Russian sentiments in Serbia.<sup>70</sup> Belgrade is pleased at the EU's soft line thus far. It was shocked to discover that Sweden, which has been very supportive of Serbia's EU aspirations and soft on conditionality, has adopted a hard line on Russia. Belgrade had previously paid no mind to Sweden's Russia policy. In Brussels, the situation has led to the development of a clearer analysis of Serbian foreign policy alignment. There seems to be a prevailing assumption that Serbia will improve its score in the near future, most probably by aligning its policy with the EU's in areas other than Ukraine-Russia.<sup>71</sup>

What remains unclear for the time being is the EU's future policy on Serbia should the conflict between the West and Russia radically escalate. Even after EU member states agreed on unprecedented economic sanctions against Russia in July, the Union continued to tolerate Belgrade's refusal to follow suit. Yet when Serbian officials began discussing the option of exploiting Russia's subsequently introduced ban of agricultural imports from the EU and several other Western countries by intensifying its exports to Russia, Brussels openly reacted for the first time. In a press conference on August 22,

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<sup>67</sup> Interviews with diplomats from different EU member states.

<sup>68</sup> Interviews with British diplomats, July 2014.

<sup>69</sup> Interview with US diplomat, June 2014.

<sup>70</sup> Interview with German diplomat, Berlin June 2014.

<sup>71</sup> Interview with an official from a Southeast European EU member state, June 2014.

Serbian Prime Minister Vučić informed the public he had received an *aide-mémoire* from the EU asking the Serbian government to refrain from any measures to promote intensification of exports of Serbian agricultural products to Russia and that it would consider such behavior as “unfair and hostile.” Vučić announced his government would abide by these “recommendations.”<sup>72</sup> When asked what would happen should the conflict with Russia dramatically escalate, a senior EU member state diplomat was firm: “In that case, Belgrade would have to choose – we would be forced to make Belgrade choose.”<sup>73</sup> Yet there is no apparent common EU-US strategy for such a scenario.

The strategic weakness of EU policy towards Serbia is abetted by the marginal role foreign policy has played in the accession processes of previous candidates. The *acquis* in Chapter 31 of the accession negotiations on “Foreign, Security and Defense policy” is soft. It consists of political declarations, joint actions, common positions and agreements and is based on legal acts, including international agreements, and political documents. Applicant countries are expected to “progressively align with EU statements and to apply restrictive measures when and where required.”<sup>74</sup> The relative softness of the *acquis* in this chapter reflects the diminishing ambition toward solidifying the Foreign and Security Policy (CFSP) following the failure of the project of a European constitution and as laid down in the Lisbon Treaty. The fact that previous candidate countries, such as Croatia or Montenegro, early on completely harmonized their foreign policy with that of the EU, leaving no need for any strong instruments of conditionality, also played a role. In these cases the EU generally demanded full harmonization by the completion of the accession process. The time period that passed between the opening and closure of the chapter was comparably short. No opening or closing benchmarks, let alone interim benchmarks, were set. Serbia started screening of Chapter 31 on July 15 this year – it is not known whether the EU plans to set any benchmarks.

Unlike the understanding the EU and the US demonstrated in Serbia’s case, neither has demonstrated comparable gratitude for **Montenegro’s** much more consistently alignment with Euro-Atlantic policy on the Ukraine crisis. The rationale for this dichotomy is difficult to identify or explain.

Prime Minister Đukanović took considerable risk domestically and internationally when he fully aligned with the EU on Ukraine-Russia. Yet at the same time, the head of the EU Delegation in Podgorica, Slovene diplomat Mitja Drobnič, casually undermined the Montenegrin Government's position, stating in a local media interview that Brussels did not demand full harmonization. Another Slovene diplomat described the statement as a “disaster - we were furious.” Drobnič later corrected himself, but the damage had already been done. No official statement emerged from Brussels from the EEAS or Commission publicly supporting Podgorica's pro-EU policy.<sup>75</sup>

While Podgorica was left without adequate EU support, it was also disappointed by European and North

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<sup>72</sup> “Serbia not endangered, respects EU,” *B92*, August 22, 2014,

at: [http://www.b92.net/eng/news/politics.php?yyyy=2014&mm=08&dd=22&nav\\_id=91377](http://www.b92.net/eng/news/politics.php?yyyy=2014&mm=08&dd=22&nav_id=91377)

<sup>73</sup> Interview with EU member state diplomat, July 2014.

<sup>74</sup> [http://ec.europa.eu/enlargement/policy/conditions-membership/chapters-of-the-acquis/index\\_en.htm](http://ec.europa.eu/enlargement/policy/conditions-membership/chapters-of-the-acquis/index_en.htm)

<sup>75</sup> Interview with EU member state diplomat, June 2014.

American NATO members. The Alliance's foreign ministers decided at their summit on June 25-26 to not grant Montenegro NATO membership at the upcoming summit in Wales, postponing the decision for 2015. It remains unclear which members ultimately prevented a positive decision. Prior to the ministers' meeting, Germany was ready to support a positive decision if the US as the most influential member state would propose it – Washington ultimately failed to do so. The decision also created substantial confusion. While membership was not granted, the door was left open for a positive decision in 2015 without the need for affirmative approval at a NATO summit, if Montenegro makes further progress on the existing reform conditions (defense reform, intelligence reform, judicial reform, strengthening citizens' support for NATO membership). Yet precisely what reforms in the four identified areas are required was not specified. Public statements were mutually contradictory. US officials stressed the need for further judicial reforms, while NATO Secretary General Anders Fogh Rasmussen noted security sector reform at a summit press conference.<sup>76</sup> One diplomat from an EU country which lobbied for Montenegro's membership bid explained that "the decision not to grant membership is totally unclear to me... Also it is unclear to anyone what the decision means, including to Podgorica. It's neither a yes nor a no. You can't sell that to the domestic audience, to citizens."<sup>77</sup>

The EU and US response to the Ukraine crisis' impact in **Bosnia and Herzegovina** is in keeping with the division and indecision which has typified Western approaches to the country in general for nearly a decade. Dodik's linkage of the Crimea crisis with his government's advocacy of RS independence has elicited statements from the EU Delegation to BiH and the US Embassy in Sarajevo rejecting secessionism. The EU Special Representative Peter Sørensen merely dismissed Dodik's statements as "noise without substance."<sup>78</sup> The EU Foreign Affairs Council was a bit more direct, reaffirming "its unequivocal commitment to the territorial integrity of Bosnia and Herzegovina as a sovereign and united country," condemning as "unacceptable secessionist and divisive rhetoric and ideas."<sup>79</sup> But the FAC failed to name Dodik or the RS Government as the proponents of such rhetoric (a common EU approach). The US Embassy stated that there is no constitutional possibility for the RS to secede.<sup>80</sup> Yet neither the US nor the EU directly confronted the RS leadership on steps it took to enlist Belgrade's support for a secession bid, let alone publicly repudiating these (unsuccessful) attempts and re-establishing credible deterrence against such a move. Instead, the EU and the US have once again lent

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<sup>76</sup> Interview with German diplomat, Berlin June 2014; "Readout of the Vice President's Meeting with Prime Minister Milo Djukanovic of Montenegro," April 8, 2014, at: <http://www.whitehouse.gov/the-press-office/2014/04/08/readout-vice-president-s-meeting-prime-minister-milo-djukanovic-montenegro>; *Public opening remarks by NATO Secretary General, Anders Fogh Rasmussen, at the Press Conference following the meeting of the North Atlantic Council*, June 25, 2014, at: [http://www.nato.int/cps/en/natolive/opinions\\_111213.htm](http://www.nato.int/cps/en/natolive/opinions_111213.htm)

<sup>77</sup> Interview with diplomat from an EU member state sympathetic to Montenegro's NATO membership bid, June 2014.

<sup>78</sup> "Sørensen: Pitanje je kada, a ne hoće li BiH ući u EU," Radio Free Europe/Radio Liberty, April 11, 2014.

At: <http://www.slobodnaevropa.org/content/sorensen-pitanje-je-kada-a-ne-hoce-li-bih-uci-u-eu/25329986.html>

<sup>79</sup> "Press Release – 3309th Council Meeting, Foreign Affairs," Luxembourg, April 14-15, 2014.

Available at: [http://www.consilium.europa.eu/uedocs/cms\\_Data/docs/pressdata/EN/foraff/142228.pdf](http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/142228.pdf)

<sup>80</sup> See "US Embassy: BiH constitution doesn't give entities the right to secede," The Bosnia Times, March 19, 2014. At: <http://www.thebosniatimes.com/en/u-s-embassy-bih-constitution-doesnt-give-entities-right-secede/>

credence to the comfortable myth that Dodik's aggressive policy is merely rhetoric for domestic propaganda purposes.

Officials from various EU member states are united in their assessment that as a consequence of the Ukraine crisis, Russia will continue to play its consistent spoiler role for Western policy in Bosnia.<sup>81</sup> The EU's reaction to the potential risk of Russian blockage of the extension of EUFOR's mandate in the UN Security Council in November mirrors the German-British divide over the Union's military mission in BiH. Unfortunately, it is not beyond possibility that EU members such as France (also on the UNSC), Germany and Italy would support such a move. They have actively advocated it before within the EU. As a German diplomat explained to the authors, Berlin had learned about "rumors" of such a Russian move, but sees "no indications this is true – in the end, what interests would Russia have to do so?" At the same time the diplomat admitted that even if Russia were to veto EUFOR's mandate extension, this would not collide with Berlin's policy position. Our position is clear for a long time – we see no need for EUFOR anymore."<sup>82</sup>

The UK and several other EU members are not so sanguine. They see a potential security risk in Bosnia's long-term institutional-political deadlock, and have taken Russia's likely challenge seriously. According to Western diplomats, London, supported by Washington, has begun to draw-up contingency plans. These could include returning the Annex 1 Dayton enforcement responsibility to NATO.<sup>83</sup> In a Russian veto scenario, NATO troops currently deployed within the KFOR mission in Kosovo could be deployed to BiH.<sup>84</sup> The new geopolitical reality thus lays bare the potential dangers that derive from the West's division over Bosnia. Should Russia block the extension of EUFOR's mandate and Berlin impede the London-led contingency plan in NATO, Germany would act consistently with its standing policy towards Bosnia and Herzegovina. This would send dangerous signals to Moscow and Banja Luka which could spur the RS leadership to move toward secession – with dire consequences.

### **Possible impact on EU-US Western Balkan policy - Conclusion and recommendations**

In the last two years, many Western Balkan countries have made considerable progress towards European – and Euro-Atlantic – integration. This was the result of the EU and the US taking decisive, joint action on at least one of the long-festering status conflicts, Serbia and Kosovo, which have blocked the countries' democratic transformations. The combination of status conflict resolution, democratic transformation and Euro-Atlantic integration has proven the most successful recipe to reduce Russian influence in the region. That influence has been exercised through Moscow's playing a spoiler role, capitalizing on Western weakness, stoking ethnic conflicts and political instability in the region with the aim of enhancing its overall geopolitical influence. Moscow has turned Serbia's pro-Russian sentiments into purely economic privileges and gains, especially in the energy sector. This has increased Serbia's

<sup>81</sup> Interviews with diplomats from different EU member states, June 2014.

<sup>82</sup> Interview with German diplomat, Berlin June 2014.

<sup>83</sup> Conversations with Western diplomatic sources, Berlin and Sarajevo, May-July 2014.

<sup>84</sup> Interview with EU member state diplomat, June 2014.

economic dependency on Russia, allowing Moscow to instrumentalize Serbia in its efforts to maintain a political influence in the region.

As a consequence of the current confrontation between the West and Russia, the Western Balkans has become part of the new geopolitical competition, as demonstrated by Moscow's diplomatic offensive towards Belgrade in recent weeks. The stalling of the Belgrade-Prishtina dialogue – the implementation of the April Agreement has basically come to a halt in 2014 – combined with the West's continued unwillingness to confront Bosnia and Herzegovina's structural policy challenge and (to a lesser extent) Macedonia's, broadens Russia's potential playing field in the region. BiH and Macedonia are the region's most problematic countries. The EU's "balanced approach" toward Belgrade on harmonization of Serbia's foreign policy towards Russia, EU officials insist, is designed to strategically balance the variables that result from the region's political challenges and Russia's assertiveness.

Yet the fact remains that the West has lost momentum on the Kosovo-Serbia dialogue. It also has an ambivalent partnership with the Vučić government, which is at least declaratively committed to European integration and democratic reform, but also is characterized by an extreme (and increasingly authoritarian) concentration of power. The EU has also struggled to devise a credible joint policy toward Russia in light of its intensifying aggression against Ukraine. The "balanced approach" might simply be a fudge for the EU's and US' difficulty in juggling multiple variables strategically. Serbia's policy of balancing between the EU and Russia may be a rational defense of Serbia's national interests by Prime Minister Vučić, especially when one takes into account the serious economic crisis Serbia is facing and the multiple structural reforms the government is currently struggling with. Yet Vučić has not yet indicated that he has a developed mid- to long-term strategy as to when and how to break with the country's traditional Russia policy, which is inevitable should it continue on the EU membership path. This is essential, not the least for the sake of Serbia's economic interests.

In order to tackle the regional challenges arising from the current geopolitical confrontation with Russia, the EU and the US should assemble behind a joint strategy to limit Moscow's capacity to create mischief and undermine Western interests. This joint Western strategy should include the following elements: a credible posture to address regional security threats regionwide, including the leverage afforded by NATO membership aspirations; further development of the EU's enlargement approach to ensure full conformity with the EU's Common Foreign and Security Policy (CFSP); and development of a common energy policy which includes EU and NATO membership candidates.

To this end, DPC proposes the following:

- The EU and the US should join forces to resolve outstanding structural policy challenges. This applies to those on which some progress has been made (Serbia and Kosovo), but also to those that have remained on the back burner: Bosnia and Herzegovina and Macedonia. Filling the power vacuum in the region will reduce Russia's latitude to act as a spoiler.
- In Bosnia and Herzegovina, the EU and the US should agree on a contingency plan to replace EUFOR with NATO troops, making use of the UN Security Council Chapter 7 mandate held by

NATO headquarters in Sarajevo. They should announce this plan to Russia in advance of the November Security Council vote on EUFOR extension in order to deter a Russian veto. EU members who have advocated ending EUFOR's executive mandate in the past – Germany, France, and Italy – should align behind maintaining a peacekeeping mission for security and geopolitical reasons.

- NATO members should rethink their June decision not to grant membership to Montenegro at the upcoming Wales summit in September. The Alliance should offer a conditional green light with clear reform benchmarks, setting a date in 2015 to enact membership should Montenegro meet these conditions in full. In this way, NATO would motivate Podgorica to implement the remaining reforms, lend the Montenegrin government the support it needs to lobby citizens for NATO membership, and meet the Alliance's geopolitical needs and interests that arise from the Ukraine crisis.
- The EU should strategically use the accession process as a lever to enforce *full* harmonization of candidate countries' foreign and security policies with the Union's Common Foreign and Security Policy (CFSP), taking current geopolitical challenges into account. This is particularly important in the case of Serbia. The EU should keep negotiations on Chapter 31 (on foreign, security and defense policy) - open until it deems it most appropriate strategically. It should also set benchmarks, including interim benchmarks, in order to strategically condition when and how full harmonization in foreign and security policy with the EU must be secured. This would be parallel to the approach toward other chapters which the Union has defined as strategically important (rule of law Chapters 23 and 24, and Chapter 35 – Kosovo, in the case of Serbia).
- In accession negotiations on Chapter 31, Brussels should make explicit linkage to the EU's Common Foreign and Security Policy, particularly in the case of Serbia. This first and foremost would subject Serbia's bilateral military cooperation with Russia to extensive scrutiny, screening it for possible collision with EU interests.
- The EU and the US must prepare a strategy in the event that their conflict with Russia escalates to the point that a changed approach to Serbia is required. This must define the conditions under which Belgrade will be asked to join EU sanctions against Russia to keep its candidacy on track. This strategy should also include financial assistance to cushion the immediate economic effects of an enforced break by Belgrade with Russia, as well as integrating Serbia into the EU's plans on how to insulate the Union from a potential energy cut-off by Moscow.
- In the wake of the Ukraine crisis, the Union has finally begun to strategically redefine its energy policy, recognizing the need for a joint EU energy policy. This may well lead to changes in the *Acquis* in the years to come. The Union should thus consider keeping negotiations with candidate countries like Serbia on Chapter 15 (energy) open as long as possible. This would allow the negotiations to take future changes to the *Acquis* into account.

- The EU should strictly apply its competition and environmental protection rules to the South Stream pipeline project, as well as ensure that candidates –and all countries with a membership perspective, such as Bosnia and Herzegovina – fully harmonize with the Union’s geopolitical interests. These have already been affected by the Ukraine conflict. The EU should give a green light to the pipeline project only if Russia shifts to a constructive policy in Ukraine and the violent conflict in the East of the country has been resolved.
- Serbia currently faces a basic strategic reform decision on modernizing its economic and industrial policy. The timing is ideal for the diversification of its energy sources and embarking on a program that promotes energy efficiency and renewables. This development would free Serbia from its current unhealthy relationship with Russia based on economic-political dependency. Ties with Russia would be transformed into a balanced relationship based on the traditional, historic and cultural ties between the two countries. This would not impede Serbia’s European integration.
- The EU should make clear to Serbia that, as a candidate, it must take Brussels’ objections and conditions on South Stream into account. At the same time, the EU should offer assistance to wean Serbia from its dependency on Russian energy and modernize its energy sector. In this context, Brussels should encourage Belgrade to join the TAP-IAP project as a means to diversify its energy supply, and provide financial support for a Serbian pipeline branch.
- The European Commission should signal to Croatia that it would block the sale of MOL’s shares in INA to Gazprom, as this would give Gazprom a near monopoly position in the Western Balkan oil production and refining sector. The EU and the US should support the Croatian Government’s consideration of purchasing a majority stake back from MOL, offering financial support toward this strategic end.