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# Russia's State-Owned Companies and Contemporary Bulgarian Political and Economic Landscape

**Abstract:** The paper represents an attempt to link energy projects of government companies of the Russian Federation with nowadays Bulgaria's political and economic environment. It focuses on the last ten years and gives deeper historical background (e.g. Bulgaria defaults on its foreign debt to Soviet banks, nuclear projects of the Communist era, etc.) only when relevant for the understanding of the contemporary situation. The first section of the paper summarizes a 2002-2015 energy project in its controversial policy environment. The second section explains the impacts on Bulgarian power sector policies, especially delays in its liberalisation, controversies around EU policies related to renewable energy and environment policies, plus public and political attitudes towards FDI's and energy resources. The power sector policies have had negative side-effects on the country's banking sector, a bank run and a bankruptcy of one bank in 2014; this experience is reviewed in the third section of the paper. The fourth part describes the impacts on Bulgaria's political establishment in 2007-2014, and attempts, instead of conclusion, a description of peculiarities of the contemporary Russia-Bulgaria controversies. The paper uses several documents and sources that are almost unknown to the international audience.

**Keywords:** Russia and Bulgaria, Russian state-owned companies, Russian influence and the EU

## Introduction

As conventional explanation of Russian Federation goes, state-owned companies like Gazprom serve as handy instrument of government geopolitical games.<sup>1</sup>

<sup>1</sup> See: E. Lucas, *Pipeline Politics: Treat and Reality*, chapter 7 in his *The New Cold War: Putin's Treat to Russian and the West*, Palgrave MacMillan, New York 2014 (revised edition); the first edition of the book appeared in Polish in 2009, and is translated into all Central and East European languages. See also: R. Ortung, J. Perović, H. Pleines, H.-H. Schröder, *Russia's Energy Sector between*

Since 2011, Bulgaria has stopped three projects: one oil, one pipeline, and a nuclear power station. Originally, all of them were praised as major pro-economic growth projects and/or game-changers of Bulgaria's power sector; then, they underwent an expert and public scrutiny, motivating resentment, criticism and eventual decision to stop and search for ways to tackle negative consequences.

Constructing a causal link between such projects and domestic and/or political constellations is a daunting task but Bulgaria may facilitate such an analysis as an interesting laboratory. This concentration of government business, domestic and international politics in a period of about seven years packaged in Russian energy projects attracted media and diplomatic circles attention but was rarely reflected and analyzed in academic fashion.

The next section of this article summarizes the nature and the history of these projects, with a reference to economic policy controversies they raised at the time. The last three parts of the article deal with economic, banking and political impacts of the package.

## **1. Russian Energy Related Projects in Bulgaria**

1. The purpose of this paragraph is to outline the technical and economic nature of the projects. They differ in many respects, but especially in the area of economic justification all of them have one common feature: they were poorly designed and had far reaching negative consequences. What is also characteristic to all of them is that they keep reoccurring in one form of another, even after activities and contracts were officially and formally terminated.

### **1.1 Oil Pipeline**

The first project to be stopped, on 7 December 2007 was the oil pipeline between the Black Sea port of Burgas and the Greek port of Alexan-

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*Politics and Business*, Forschungsstelle Osteuropa Bremen, "Arbeitspapiere und Materialien", 2008, no. 92, <http://www.forschungsstelle.uni-bremen.de/UserFiles/file/06-Publikationen/Arbeitspapiere/fsoAP92.pdf> [02.10.2015].

droupoli, in eastern Greece, on the border with Turkey. The estimated capex of the project was originally about USD 1 bln, and its function would be to bypass the Bosphorus and Dardanelle straits supplying Caspian and Russian oil to the West. The government of Bulgaria (GOB) withdrew from the project referring to environmental and supply concerns, and the resentment of the local population (expressed in a referendum). The intergovernmental agreement with Russia and Greece was terminated by Bulgaria's parliament in March 2013.<sup>2</sup>

The investment scheme was not agreed upon or no details were disclosed. What was clear is the following: In the company to build and operate the pipeline, Trans Balkan Pipeline, Russian state-owned Rosneft, Transneft and Gazprom Neft had 50% of the pipeline, while Greece and Bulgaria would share equally the remaining 50%.<sup>3</sup> Greece's share were distributed by the state-owned Hellenic Petroleum and TH-RAKI (1% share was reserved for the government of Greece); Bulgaria needed either to establish a new company – all companies in the sector were already private – or sell its stakes. The GOB chose the former approach and registered a new Burgas-Alexandroupoli Project Company BG, owned 50/50 by state-owned companies from other sectors, TechnoExportStroy and Bulgargas Holding, a Bulgarian analogue of Gazprom (although without any production of oil or natural gas).<sup>4</sup> Then, there was a minor controversy about which companies would have the right to buy the respective 24.5% of the overall pipeline business, and the agreement was that Chevron, KazMunajGas (proposed by the Russian party) and TNT BP would be allowed to become shareholders.

- 2 Facing early general election in May that year, the GOB decided that the legislature should renounce the agreement. Similar were the tactics with the decision to stop the construction of the nuclear power plan "Belene": the GOB announced it resigns from the project for financial and economic reasons in March 2012, and one year later it proposed a motion in the parliament to terminate the agreement between the Russian and Bulgarian state-owned companies involved in the project.
- 3 Originally the idea was that the Russian stake is 51%.
- 4 After the project was closed in December 2011, the company has become a property of the ministry of finance of Bulgaria; before this article went into print, at the end of September 2015, Burgas-Alexandroupoli Project Co BG still existed. In May 2015, it was re-equipped with a new CEO and a Board of Directors (see: *Bulgarian Project Company for Oil Pipeline Burgas-Alexandroupolis Welcomes New CEO*, "Novinite", 27.03.2015, <http://www.novinite.com/articles/167535/Bulgarian+Project+Company+for+Oil+Pipeline+Burgas-Alexandroupolis+Welcomes+New+CEO#sthash.17RpRmYM.dpuf> [02.10.2015]).

There was a vocal political support on the Bulgarian side for the project. After the signing of the general Cooperation Agreement between President Putin and PMs of Bulgaria, Stanishev, and of Greece, Karamanlis, in March 2007, Bulgarian promoters of the project focused on selling it to the public. President Parvanov, the ex-Chairman of the PM Stanishev's Socialist Party, praised the pipeline as "the first part of Bulgarian Grand Slam in the power sector," the other two parts being the second nuclear power station and the new gas pipeline, all involving Russian companies as investors, suppliers, providers of core technology and energy resources, and as creditors. Mr Parvanov still repeats from time to time that he said "Grand Slam will convert Bulgaria into an energy Power House of South-Eastern Europe."<sup>5</sup>

The "Grand Slam" rhetoric was not enough to convince the public, which started asking questions about the costs of the project, its environmental dimensions, and sought access to the recordings from the meetings of the President of Bulgaria with his Russian counterpart.<sup>6</sup>

Unlike the socio-economic impact study on the Greek rout of TBP (about 130 km),<sup>7</sup> neither Bulgarian authorities nor the academia attempted to assess the effects of the pipeline on its 160 km of territory. The authorities focused on the EIA, and requested from TBP two

- 5 Originally, Mr. Parvanov named this way the three-set Russian energy package on January 18, 2008, on the occasion of signing the South Stream Agreement. The fact of the signing did not trigger much of immediate enthusiasm in Bulgaria or abroad, rather the opposite: it was interpreted as an alternative of the EU sponsored Nabucco Pipeline. For a good summary of the international reactions see: *Russia-Bulgaria Package Deals Arouse Energy Concern*, "ChinaView", 19.01.2008, [http://news.xinhuanet.com/english/2008-01/19/content\\_7452186.htm](http://news.xinhuanet.com/english/2008-01/19/content_7452186.htm) [02.05.2015]; Y. Dachkov, D. Trankova, *Doomed to Friendship: Bulgaria Torpedoes the West's Efforts to Diversify its Energy Sources*, "Vagabond", 01.02.2008 (the article contain background information on Bulgaria-Russia relations and on the three projects), <http://www.vagabond.bg/politics/item/614-doomed-to-friendship.html> [02.05.2015].
- 6 The meeting of both presidents, held on 13 November 2009, reportedly boosted the dormant pre-investment activities; a journalist from a rather extreme patriotic newspaper from the city of Burgas (which was preparing for a municipal referendum on the pipeline) requested access to the records of the meeting but the request was left with a silent refusal; the journalist, assisted by the non-government access to information watch-dog, Access to Information Program (AIP), had taken the president's refusal to the court, and, on November 11, 2010 the Sofia Administrative Court ordered the president to publish the requested file (see for details on the court case: *AIP, Lachezar Lisicov (Desant daily) vs. the President of Bulgaria*, <http://www.aip-bg.org/library/dela/case113.htm> [02.10.2015]).
- 7 See: K. J. Hazakis, J. C. Mourmouris, *Social Impact Assessment of FDI in Energy Projects: Burgas-Alexandroupolis Oil Pipeline as a Case Study*, "International Journal of Trade and Global Markets", vol. 5, 2012, no. 3/4, p. 299-315.

updates on technical matters. The EIA found no significant environmental risks but it caused delays for the take-off of the construction and the findings did not have any convincing effect on the public opinion. In Burgas and two neighbouring municipalities making leaving of summer tourism (Pomorie and Sozopol) the residents who took part in the vote overwhelmingly rejected the construction of the pipeline.

The delays and technology changes had raised, naturally, the costs of the TBP investment. According to independent assessments, the costs went up to USD 1.5-1.6 bln. The GOB focused on the so called benefits, and project proponents quoted USD 30-35 mln revenue annually from transit fees, and expected 1,000 jobs to be created. There was no disclosure of details on how the calculations were made and where the jobs could come from. A closer look by independent economists, including the author, has led to more realistic conclusions about the project benefits: the annual net budget revenue would be below the daily government expenditure, the return on investment period is 17-19 years, and the total job creation could be 35-40% less than the GOB expectations.

In February 2013 and June 2015, Russian authorities announced they would seek a reopening of the project.

## 1.2 Belene Nuclear Power Plant (NPP)

In 1970s, Bulgaria's planned economy invested in creation of nuclear power sector in order to supply electricity to centrally planned and inefficient heavy industries. Then, the economy was functioning on recycling subsidies, raw materials and energy resources supplied by the USSR and selling the output to the international market at normal prices. The profits, price differentials between COMECON and the global market, were partially used (especially in the 1980s) to set companies outside Bulgaria to bypass technology transfer and arms-trade embargoes, like CoCom, to repay government debts to the Soviet Union and to support friendly to the Communist camp regimes in Africa and Latin America.<sup>8</sup> The nuclear power station of Kozloduy,

<sup>8</sup> The communist Bulgaria defaulted on its foreign debt three times: in 1960 and 1976 on its debts to Moscow, and in late 1980s – on its debts to a London club of private lenders.

with four 400MW and two 1000 MW VVER reactors, which became fully operational in late 1980s, was believed to be insufficient for such a “strategic plan,” so a second NPP, again on the river Danube, near a small town of Belene was planned. It spanned for more than 35 years, but in a nutshell the history is as follows.<sup>9</sup>

Following the 1977 earthquake in nearby Vrancha (in Romania), Soviet designers dropped the project for seismic risks in 1981. It was restarted in 1985, on the insistence of GOB, with 4 VVER/1000, the site was constructed and the first reactor bought, 40% of the original investment was completed by 1989, when economic difficulties and lack of financing necessitated a redesign of the NPP for two reactors instead of four.

In early 1990, the BAS socio-economic review had found the entire investment unreasonable for radiological, seismic and economic risks (the country already defaulted of its foreign debts). At the same time, the population from neighbouring Belene Danube districts and environment groups launched protests, petitioned the parliament and threatened civil disobedience campaign against the project. Following committee hearing in the parliament, the first post-Communist government decided in August 1991 to freeze the construction for predominantly financial and economic considerations.

In the 1990s, there was a brief attempt to revisit the plan for a second nuclear plant, but the idea was dropped because of a lack of any economic justification – the economy had already a new structure and there was a persistent excess of production capacity, electricity that the country could not consume or export.

In April 2002, without required justification, Belene NPP was announced for reopening. At some point, a reason was found in the fact that the first four (small) Kozloduy reactors must be closed with formal accession of Bulgaria in the EU – those reactors lacked overhead pro-

<sup>9</sup> I personally had numerous occasions to deal with the “Belene”: first, for purely academic curiosity I followed the economic efficiency of the project since 1986; then I was a member of the Bulgarian Academy of Sciences team (socio-economic sub-team) to assess NPS “Belene” in 1989-1990; later, as chairman of the Environment Committee of the Constitutional Assembly (1990-1990), I was involved in the decision making to discontinue the construction; and, in more recent years, on behalf of the Institute for market Economics (IME) I was responsible for assessing the reopening of the project in 2002-2005, and for leading an interdisciplinary team of experts to conduct a cost-benefit analysis of “Belene” in January-May 2011.

tective construction and did not comply with EU standards. The cost of the early shutdowns has been estimated at EUR 3 bln, and, in principle, it would have made sense operating at least two of those reactors until 2009-2010 (a scenario that was being negotiated with the EU).

In other words, Belene with two 1000 MW reactors was conceived as a substitute of the closed Kozloduy capacity some time after the formal entry in the EU (scheduled for 2007). Two months earlier, the ex-king, then PM, Simeon Sax-Cobourg-Gotta, committed to immediate (i.e. before the EU accession) closure of Kozloduy reactors at a meeting with his Greek counterpart, Kostas Simitis.<sup>10</sup> The motion to restart Belene contradicted both the independent and GOB assessment of the country's energy balance (calculated by non-government experts) which demonstrated that power sector investment, thermal power plans (TTP) on domestic lignite fuel, would fully serve the needs of both domestic consumptions and exports (as the GOB calculated in its 2002 Energy Strategy). A year earlier, the construction of two TTPs was contracted with Italian and US companies, Enel and AES; the project financing was committed through power purchasing agreements and the takeoff deadlines of the TTPs were for set to coincide with the closure of Kozloduy small reactors.<sup>11</sup>

This tactics motivated critics from environment groups, independent economic think tanks, non-government energy experts and other civic organization. In order to respond to the critics, the GOB granted some access to information on the project,<sup>12</sup> organized hastily public hearings at which independent experts had restricted access to information and limited opportunities to take the floor, and redrafted

10 The decision to restart Belene was first officially announced by Simeon Sax-Cobourg-Gotta on 6 April 2002, at a convention of his party, National Movement Simeon the Second (Natsionalno Dvizhenie Simeon Vtori – NDSV).

11 By the end of 2010 both plants became fully operational, and were the first in Bulgaria to fully comply with EU environment standards.

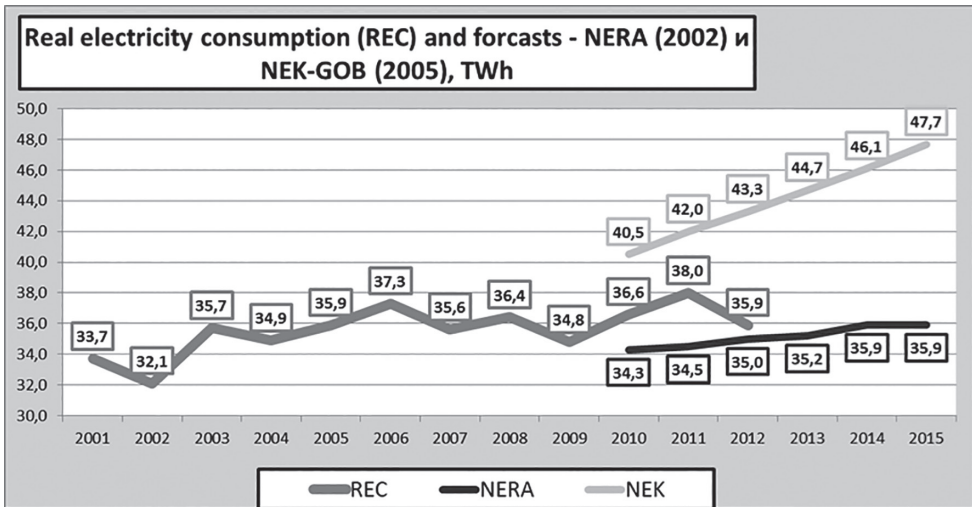
12 In fact, the first disclosure was a response to the Institute for Market Economics (IME) request for information: IME was given a disc with different presentations on the project with a warning "not for distribution" – the files were immediately made public. The full access to information was not granted for the public hearings, only after them the court ordered the Council of Ministers to open the dossier of the project, but the authorities never fully complied with access to public information standards; AIP had won four court cases dealing with access to information about Belene NPP (see a selection of publications describing the saga available at: <http://www.aip-bg.org/search.php?lang=en-us&q=Belene> [02.10.2015]).



the energy balance forecasts using newly and post-factum produced data by the state-owned National Electric Company, NEK.

The following table demonstrates the difference between the real electricity consumption and the forecasts of NERA Economic Consulting (a UK based company that assisted 2002 Energy Strategy) and of NEK.

Table: Real electricity consumption and forecast



Source: Ministry of Economy.

NEK forecast obviously exaggerates the need for an extensive development of Bulgaria's power sector. Its interest in the Belene project was one of ROSATOM<sup>13</sup> project partner with 51% of the shares. By that time NEK has already borrowed EUR 320 mln from BNP Paribas to finance its stake and desperately needed a continuation of the project. NERA's forecast is much closer to reality, although the actual consumption after 2013 hovers below 34 TWh, and has little prospects of exceeding this threshold in the foreseeable future. The macroeconomic data also suggested that electricity consumption would

<sup>13</sup> ROSATOM is a Russian state-owned holding, established in 2007 and uniting some 50 companies and organizations, in fact a reregistered Ministry of Nuclear Energy.



remain flat: the real GDP growth between 2001 and 2010 was 56%, while the real electricity consumption (which includes also exports) fluctuated around 35 TWh.

In this situation, the GOB took for granted the NEK forecast, which was 37% above the available outsiders' forecast for 2015 and 39% above the actual consumption for the same year.<sup>14</sup>

Similar to Burgas-Alexandroupoli pipeline Belene project had no clear and up-to-date economic or technical feasibility study. According to Bulgaria Nuclear Energy Law, Article 45, such a study along the assessment of socioeconomic impacts, seismic and radiation risks is a precondition to decide whether to plan construction of a NPP or not. Similarly, the Energy Law stipulates that new power stations should be built only when it is determined that there is a need to meet domestic consumption.

Three governments of the period 2002-2012 failed to deliver those studies in any acceptable and convincing version. Typically, they referred to different ideas like president Parvanov's "Grand Slam," of "Bulgaria as an Energy Hub," etc. One of the consultants, Parsons Europe, referred in 2004 to an estimate of project costs in the range between USD 1 and 4 bln. In support of the "Hub" argument, the proponents of the project spoke of "great export opportunities," irrespectively of the fact that foreign demand (exports) is a dubious justification for building a NPP with taxpayers money and for handling nuclear waste fuels at citizens' risk (the above quoted legal framework explicitly envisages a different approach).

The preparatory period for the project took some time, the formal decision was taken by the GOB in 2005, the assumed costs of the investment then were at the level of EUR 1 bln. The tender specification envisaged reactor type VVER/1000; no international supplier took part but Atomstroyexport (ASE), a subsidiary of ROSATOM; in 2006 it won a contract to build Belene. In 2007 RWE, German utility investor and operator, won a bid (with ten competitors) to contribute 49% of then estimated EUR 3.8 bln. After sixteen months of negotiation, in October 2009 RWE resigned from the project, referring to its

14 In the fall of 2012, parliamentary hearing on "Belene" had made GOB to admit that "the expectations were way too optimistic" and to recalculate more optimistic energy balance.

high integrity standards and unclear terms of financing. As World Nuclear News (WNN) reported: “Bulgarian national utility NEK was to take the controlling 51% stake, but the company and government have been unable to keep to the terms of a pre-construction finance deal with BNP Paribas, leading to penalties, and RWE had been unable to find a junior partner to share its stake.” This, continued WNN, is what “leaves a strange situation where private finance has turned its back on a large investment that has full government support. Furthermore, there is a total support from Russia for its reactor exports, and the leaders are happy to authorize loans to Bulgaria to make the project happen. Contracts for major components for the reactors were announced only yesterday, indicating very strong Russian confidence that Belene will still go ahead.”<sup>15</sup>

In early 2010, ASE asked for EUR 6.3 bln of loans and then, in 2011, reassessed the investment costs at EUR 8.2 bln. By that time, the project was already a full responsibility of NEK, its principal state-owned umbrella, the Bulgarian Energy Holding (BEH) and the GOB.<sup>16</sup>

The obvious lack of transparency<sup>17</sup> enthused independent experts as early as in 2002 to start working on its own cost-benefit analysis of the project. The first fully-fledged report on the subject was published on 28 March 2011. It estimated the total construction costs of Belene at EUR 11.4 bln, assuming no delays, no kick-backs and no price increases due to post-Fukushima nuclear safety updates.

15 See: *RWE Pulls out of Belene*, “World Nuclear News”, 28.10.2009, [http://www.world-nuclear-news.org/C\\_RWE\\_pulls\\_out\\_of\\_Belene\\_2810092.html](http://www.world-nuclear-news.org/C_RWE_pulls_out_of_Belene_2810092.html) [02.10.2015].

16 BEH was established in September 2008, when Bulgargaz Holding was renamed BEH and its capital was increased through an in-kind contribution at par value of all the shares in the capital of NEK, NPP Kozloduy, the lignite TPP Maritsa East 2 and Mini Maritsa Iztok (lignite coal mine). The idea to establish BEH was promoted by president Parvanov, besides public criticism, in order to promote the “Grand Slam.” In fact, the GOB needed a company with clean balance sheet to borrow from international private creditors because NEK, due mainly to its failing shareholding agreement with ASE and other ineffective projects, was brought effectively to a state of bankruptcy.

17 This approach generated diplomatic attention to the ways GOB handled the project, see, e.g. Wikileaks: *US Embassy Cables; More Troubles at Bulgarian Nuclear Power Plant*, “Novinite”, 21.12.2010, [http://www.novinite.com/view\\_news.php?id=123409](http://www.novinite.com/view_news.php?id=123409) [02.10.2015], a reprint from The Guardian. The cable mentions, between other things, that “the Bulgarians are still in the dark on actual details. Tosheva [CEO of Bulgaria Energy Holding] told us that she expects Russian PM Putin will dictate the loans terms directly to Bulgarian PM Stanishev.”

The IME report gave also a full account of the side effects and the history of the project from 1970s to present days.<sup>18</sup>

Public debates sparked by IME, AIP court cases against GOB refusals to disclose information on the project, activities of the Institute for Regional and International Studies (IRIS), Centre for the Study of Democracy (CSD)<sup>19</sup> and a Belene-motivated pressure group, Movement for Energy Independence, eventually led to GOB reassessment of the project, for which it selected HSBC as a consultant (in April 2011).

In mid-July 2011, another private think tank, specializing in energy affairs, the Institute for Energy Management Institute (EMI), a private think tank supported by the power sector companies, published its Belene price estimate EUR bln but used a different methodology.<sup>20</sup> Around the same time, Russia's ex-Minister of Nuclear Energy and Deputy Chairman of the Institute of Natural Monopolies, Bulat Nigmatulin, calculated the project investment costs at EUR 14.5 bln. He too used a different methodology and took into account possible delays and updated security standards. In February 2013, he reconfirmed his calculations and provided a broader background assessment on Russia–Bulgaria energy projects in a speech before the Economic Policy Committee of the Parliament of Bulgaria.<sup>21</sup>

Eventually, in April 2012, HSBC submitted its assessment to GOB, which published the bank presentation but not the report; the costs were found to be at least EUR 10.26 bln<sup>22</sup> or 13.99 bln (with added security costs).

18 See, in Bulgarian: Институт за пазарна икономика, *Какво да се прави с проекта АЕЦ «Белене». (Оценка на необходимостта, рисковете, разходите и въздействията)* [What to do with NPP Belene: Assessment of Needs, Risks, Costs and Impacts], София, ИПИ, 28.03.2011, [http://ime.bg/var/images/NPS\\_Belene\\_Assesment\\_WTD.pdf](http://ime.bg/var/images/NPS_Belene_Assesment_WTD.pdf) [02.10.2015].

19 See: IRIS publications on the topic available at: <http://iris-bg.org/index/currentprojects/catid/2/itemid/53>, and a list of CSD publication and events available at: <http://www.csd.bg> [02.10.2015].

20 See: EMI assessment available at: <http://www.emi-bg.com/en/index.php?id=679> [02.10.2015].

21 See: Н. Нигматулин, *Правда об АЭС «Белене», «Pro-Atom», 12.02.2012*, <http://www.proatom.ru/modules.php?name=News&file=article&sid=4317&modes=flat&order=1&thold=0> [02.10.2015].

22 It needs to mention that HSBC contracts included a success fee of 1% the total investment, provided the project is completed and the NPP is built. See estimates: HSBC Project Finance, *Project Belene Presentation of the Operational Model (prepared for BEH)*, Sofia-London 2013, [http://www.mi.government.bg/files/useruploads/files/vop/belleville\\_financial\\_modelling\\_presentation\\_to\\_beh.pdf](http://www.mi.government.bg/files/useruploads/files/vop/belleville_financial_modelling_presentation_to_beh.pdf) [02.10.2015]. The full text of the HSBC report was eventually published in 2013, after Sofia District Court, on 24 July 2013 decided positively on access to information claim by NDSV, Sax-Courburg-Gotta's political party (its government was the first access to Belene-related studies and reports), ordering GOB to publish it.

The story did not end here. The Bulgarian Socialist Party (BSP), whose previous chairman Parvanov believed Belene was a part of his Grand Slam whose incumbent chairman Stanishev was PM when the framework agreement with ASE/ROSATOM was signed, in order to boost its pre-electoral discipline and organization, collected 500,000 signatures and initiated a referendum on the continuation of the project. The question was misleading, merging two points – an approval for atomic energy as such and for the “new” NPP (without explicit mentioning of Belene).<sup>23</sup> Before the campaign, which coincided with Christmas and New Year holidays, some public opinion polls indicated about 60% approval rate for Belene. The vote took place on 27 January 2013, but was not valid: the law requires 60% voters’ turnout, only 20% actually voted (the result was 61% “yes” and 38% “no”). In such cases, the legislature should decide, and on 27 February it voted against Belene, the cabinet decision to stop the project was taken a month later, on 28 March 2013.

In the meantime, on February 20, in Sofia public protest started against “high” electricity prices; in a few days it grew into a protest about everything, and several young men were beaten by someone, allegedly the police. The incumbent PM used the occasion to resign and fresh election were scheduled for 12 May 2013.<sup>24</sup>

### 1.3 South Stream

The preliminary agreement between Russia and Bulgaria on the South Stream was signed in January 2008, and ratified by the parliament

23 Voters were asked the question “Should nuclear energy be developed in Bulgaria through construction of a new nuclear power plant?”

24 It has never become clear what exactly motivated the street protests, Bulgaria electricity prices are the lowest in EU. They were raised by the regulator in July 2012, by 12-13%, because it was obvious that prices were kept artificially low, not covering production, large investment and distribution costs in the power sector. There was no major discontent until February next year, when for the first time three-month electricity bills were sent to consumers. The rhetoric about “poor Bulgarians” looted by “foreign electricity distribution monopolies become widespread” (Czech, German and Austrian companies operate the electricity retail). Several facts were omitted from the heated debates on electricity bills that February: a) the distribution companies do not set the electricity prices. The regulator does; b) a part of the “high” costs resulted from grandiose projects like Belene; and c) in 2002-2005 electricity prices were picking up by 15% per annum, while the real income of the households was almost 60% higher than in 2013.

in July that year. Bulgaria was the first EU country to reach such a contract. It was concluded by then PM Stanishev, leader of BSP then, now – of the European Socialists. This happened in some rush, again with little preliminary assessment of costs and benefits and with unclear financing.

The core idea of this element of the Grand Slam was to bypass Ukraine and a transit country in transporting natural gas to EU, create a leverage to exercise pressure on Kiev, and set a fast-track alternative to Nabucco. Last but not least, the Stream could increase the falling Russian export of natural gas to Europe.

Between 2002 and 2012 the average EU natural gas import dependency on Russia has been going down by almost 1/3, from 45.2 to 32%. However, for five EU countries – Bulgaria, Slovakia and the Baltic countries – it was above 94% for the same period, according to EU-ROSTAT.<sup>25</sup>

For GAZPROM and other Russian exporters, this was a reasonable strategy to boost trade before the entry into force of the so called Third EU Energy Package (TEP), which requires liberalization of-, and third party access to the energy distribution infrastructure. In order to succeed, the ultimate prerequisite of this approach was to own the pipeline and have the right to exclude both competitors and “unfriendly” governments; control the volumes, prices and transit fees. Those who planned to invest in domestic natural gas exploration and production, conventional or shale, would be then required either to build their own pipeline or pay the existing operators.

In reality, however, the deeper and more tacit presupposition for the project was that in the countries on route there should be cooperative, “friendly” leaders and politically controlled companies ready to grasp the opportunity and launch the pipeline before the implementation of the (TEP). Since exclusive ownership and discrimination of access contradict the EU law (scheduled for implementation from 1 January 2016 onwards), these collaborative politicians should secure the legal framework for the stability of the pipeline operation.

25 See: Eurostat Statistics Explained, [http://ec.europa.eu/eurostat/statistics-explained/index.php/Main\\_Page](http://ec.europa.eu/eurostat/statistics-explained/index.php/Main_Page) [11.10.2015].

It is disputable whether such expectation on behalf of GASPROM is at all reasonable in the first place, but this is exactly what happened in Bulgaria. In 2014, two Socialist MPs, both with high government post in the energy sector in the past, proposed amendments to the Energy Law, which: a) refer to “EU pilot projects” in the justification of the amendments; b) introduce a new concept of “sea gas-pipelines,” defined as “inter-systemic gas-pipeline;” and c) excludes from the EU jurisdiction the sea-rout and on-shore infrastructure of such pipelines. The draft was adopted at the first hearing, with almost no debate by the parliament on 4 April 2014.

This prompted extra-parliamentary opposition to look closely into the background of the initiative, and using procedures of the access to information law they obtained records from BEH-GAZPROM about 13 December 2013 talks regarding “South Stream Transit Co.” – the company set to build the pipeline, majority owned by GAZPROM. According to the record, the parties admit they are not obliged to give access to the pipeline to any third party. The wording and the argument of this agreement resembled to the very letter the justification and provisions of the law adopted in April.<sup>26</sup>

The finding created a public outrage<sup>27</sup> and the European Commission declared it is launching an investigation on alleged breach of the EU law and jurisdiction.

All these happened after the official start of South Stream construction, with a ceremony involving Bulgaria’s PM Oresharski, the Energy Minister Stoynev and Russia’s Energy Minister, Novak, on 31 October 2013. The construction on Bulgarian soil, judging from the tender documentation, is 2.5 to 3 times more expensive than the construction of a similar North Stream pipeline on German territory. In order

26 See for some details: *Bulgaria’s Energy Minister Troubled by EU’s Procedure against South Stream*, “The Banker”, 23.05.2014, <http://www.banker.bg/briefs/read/bulgarias-energy-minister-troubled-by-eus-procedure-against-south-stream> [02.10.2015].

27 From June 2013 to early August 2014, Bulgaria was governed by a minority government sponsored by the Socialist, the Movement for Rights and Freedoms (MRF, a party which Bulgaria Muslims vote for) and nationalist and openly pro-Russian (it is an obvious contradiction in terms) political party ATAKA. The period in office of this government was accompanied by every-day street protests, denouncing one of its policy after another. See for details on political parties, leaders and public discontents related to that period: K. Stanchev, *Another Sort of Occupy Movement: Bulgaria*, “4Liberty”, 30.12.2013, <http://4liberty.eu/another-sort-of-occupy-movement-bulgaria/> [02.10.2015], an earlier version of this article was published in Polish.

to start the project, in July 2013 BEH (the ultimate principal of Bulgarian companies involved in the project) borrowed EUR 290 mln from private lenders.

Eventually, in early June 2014, bending to pressures from the EU, the constructor of the pipeline, PM Oresharski ordered all activities to stop. Later in the year, during a press conference in December in Turkey, President Putin announced Russia's withdrawal from the South Stream and its conversion into a Turk Stream, blaming the lack of success on the EU and Bulgarians. Besides all these public moves and rhetoric, the state-owned firm "South Stream Bulgaria," a junior partner in the GAZPROM consortium, is still in operation. It was not deregistered because there was no legal document by the main shareholder that operations had stopped and pipeline was not to be built. Meanwhile, 31 July 2015 Turk Stream talks were put in the freezer, until November.<sup>28</sup>

## 2. Impact on the Power Sector

Not so much the oil pipeline but Belene NPP and South Stream projects have had a long term negative impact on Bulgaria's economy and its energy policy framework.

Designed for servicing a huge heavy industrial sector, Bulgaria's installed electricity production capacity has become rather obsolete with the disappearance of the COMECON protected market and bankrupted, loss making enterprises (as early as in the mid-1980s). Bulgaria's electricity distribution network was detached from that of COMECON/USSR in 1993, so the starting year of Bulgaria's electricity meter" is 1994. Since then, the country "enjoyed" electricity surpluses of at least 10% on average, which were difficult to consume or export. Strangely enough, in per capita terms Bulgaria still produces more electricity than European part of Russia (6.3 KWh per person versus 5.9 KWh in Rus-

28 See for detailed background EuroActiv list of publications on Turk Stream: <http://www.euractiv.com/topics/turkish-stream> [02.10.2015]. A somewhat optimistic assessment of the Turk Stream prospects has been recently published by Stratfor, see reprint by Natural Gas Europe, *How the Game Is Played: The Life and Death of South Stream*, <http://www.naturalgaseurope.com/how-the-game-is-played-the-life-and-death-of-south-stream-25486> [02.10.2015].



sia), even more than the neighbouring countries (Greece production is 5.1 KWh per person, Italy's – 5 KWh, Serbia – 3.9 KWh, Hungary – 3.7 KWh, Turkey 2.9 KWh and Romania 2.8 KWh).<sup>29</sup>

## 2.1 Institutions

This legacy had three institutional impacts, which determined the context of the Russian energy project in Bulgaria.

First, there was little pressure to privatize and seek efficiency, prices were kept artificially low for years and still are relatively low in comparison to those in the EU. Compared to the regional electricity market, in 2012 Bulgaria's still administratively determined prices were 51% lower than in the Czech Republic, 47% less than in Turkey, 40% below the Greek prices, 61% lower than electricity prices in Hungary and about 12% below Romanian.<sup>30</sup> This situation, on one hand, created incentives to waste electricity: Bulgaria is the most energy wasting economy in Europe, with a relatively very high degree of import dependency. On the other hand, there is a disincentive to invest: the inputs in terms of technology, grid-line, equipment and meters are available on the international market but the domestic price hardly covers the costs.

Second, there was little reason to liberalize the electricity market, NEK as a single buyer remained and still is in place. Until 2001 the prices remained virtually untouched or at last they were not covering investment and maintenance costs. The electricity price was set to rise 45% for the period 2002-2005, thus opening doors to privatize (the electricity distribution was privatized in 2004) and liberalize (the respective preparation started, frameworks were adopted; and the start of the free market was planned for 1 July 2007). This did not happen.

Third, the wrong set of incentives made it all but impossible to invest and modernize, except in extensive projects requiring more capacity and resources, and financed on project-by-project bases (since

<sup>29</sup> See above quoted article by Bulat Nigmatulin.

<sup>30</sup> See: Eurostat Statistics Explained, *Energy Prices Statistics*, [http://ec.europa.eu/eurostat/statistics-explained/index.php/Energy\\_price\\_statistics](http://ec.europa.eu/eurostat/statistics-explained/index.php/Energy_price_statistics) (the comparison for later years would be misleading because in most of the countries markets are already in an advanced stage of liberalization).

bankability was risky in a non-market environment). After more than 30 years of no development, in 2001-2002 power purchasing contracts were used to finance clean and state-of-the-art lignite TPPs. As mentioned above, they were planned substitution for the closure of old Kozloduy reactors and to comply with EU environment standards. Later, in 2008-2009, Bulgaria opted to comply with EU energy policy and set for subsidized wind and solar power plants. The NEK was and still is the single buyer of this new capacity.

In this situation, Russian state-owned companies were sort of a “dream partner,” ready to operate in such an environment. But the outcome was that these projects further worsened the performance and the governance of the sector.

The most important negative institutional impact of the Belene project. Launching it at the time of preparation of the electricity market for liberalization, the GOB needed a structure like NEK to play the role of both a core single buyer and a partner of ROSATOM in the project. If liberalization were really to happen in 2007, NEK would lose the position in the system which could guarantee power purchasing from the new NPP plant. So, the system and NEK became a hostage of the project.

## 2.2 Energy Dependency and Inefficiency

Bulgaria imports from Russia 100% of the nuclear fuel, and Russia (ROSATOM) recycles the fuel used in Kozloduy.

In 1998-1999, the largest oil refinery on the Balkan Peninsula, Neftochim in Burgas originally designed in 1960s to refine crude oil from Russia, was sold to Lukoil. Between 2000 and 2014 Bulgaria imports 98% of oil from Russia.

GAZPROM supplies 96% of natural gas; Russian and Ukrainian companies supply 42% of solid fuels, mostly non-lignite coal.

Currently, the overall energy import dependency from Russia is 72-73%. If Belene were to be built and operated, the dependency would rise to approximately 80%, with 76.6% of the electricity produced from Russian nuclear and gas with 71.15% Russian equipment.

Speaking energy dependency, we should also take into account the impact of the South Steam project. This should be considered first of all an institutional impact.

In 2010-2011, three concessions were granted to explore natural gas deposits, one of them for natural gas shale (Chevron won the tender) in North East Bulgaria, one from coal, and one unspecified. In January 2012, responding to a week of media campaign and one weekend of street actions by environmentalists in Sofia and some other big cities, the parliament overwhelmingly voted a ban on fracking. It happened without any specific discussion of pros and cons, with no account for costs and the side effects. The penalty of USD 66 mln was imposed, three times above signature fee for the concession permit. Even the geophysical and seismological tests and information gathering, totally harmless from environmental standpoint but needed for at least knowing the commercial viability of the deposits, became unreasonable.

The assessment of the probable socio-economic costs and impacts of Bulgaria's natural gas from shale potential was produced by a private team of experts (led by the author) only one year later, in March 2013. It found that, depending on the actual deposits, the natural gas dependency could be reduced to 50% or even 25-30%. In retrospect, it is obvious that the ban cleared the prospect for GAZPROM dominance and set potential South Stream advantages.<sup>31</sup>

After RWE pulled out of the Belene project and NEK remained the sole ROSATOM partner, the company balance sheet deteriorated. The full completion of Belene, even of the lowest ever quoted price of EUR 4 bln, would have meant nothing less than bankruptcy – by end of 2011, NEK's total assets were EUR 4.05 bln. By that time it has a debt to BNP Paribas of EUR 320 mln, a work and equipment on Belene of roughly EUR 1.2 bln, EUR 750 mln costs of hydro power station (completed in 2009) and, on top of it, outstanding payments on power purchasing agreements with newly build and put in operation TPP, solar and wind farms. It is difficult to access the exact volume of these areas, because regulations and prices changed several times and there are several court disputes on payments and regula-

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31 See: K. Stanchev (ed. and team leader), *Natural Gas from Shale Socio Economic Impacts for Bulgaria*, KC2 Ltd., Institute for Management of Energy Sofia 2013, [http://ime.bg/var/images/Natural\\_Gas\\_from\\_Shale\\_for\\_Bulgaria\\_KC2\\_Study\\_27-2-14\\_EditedENG.pdf](http://ime.bg/var/images/Natural_Gas_from_Shale_for_Bulgaria_KC2_Study_27-2-14_EditedENG.pdf) [02.10.2015].

tions. In any event, the outstanding payments are estimated at the level of EUR 1.25 bln.

The continuation of the project would have led to immediate bankruptcy of NEK and the entire system. The closure of the project was justified only by this situation. However, even if we assume that NEK's financial condition was perfect, the operation of a second NPP station would mean closure of existing production capacity in the non-nuclear segment of the power sector, and social costs in terms of lost jobs and investment, plus a mess in the banking sector as the new TPP were built with roughly EUR 2 bln of syndicated loans (domestic and international banks) and, in their turn, the renewable sector has been financed with another 2 bln.

The reason is very simple: the system with four 1,000 MW reactors (two in Kozloduy and two at Belene NPP), with little to no opportunity to export at a price that covers the costs on investment in the system (Belene was totally unnecessary from the standpoint of the domestic consumption until at last 2025 and probably until 2030), the more flexible segments (coal and water power plants plus the renewables) would have to be non-operational for a period of four to five months a year. Another dubious alternative would have been to close Kozloduy.<sup>32</sup>

## 2.3 Energy Sector and Bank Failures

2014 was a very odd year for the Bulgarian banking industry. The sector used to be very stable and well capitalized, deposits covered (and still do) all extended credits, saving rates are higher than ever (private savings are at the level of 60% of GDP), non-performing loans are the level of 19% and steadily go down after the butts of 2009, reserves are three times higher than EU average, and capital adequacy ratio was also better than the average. Unexpectedly, one bank – Corporate and Commercial Bank (CCB), the fourth bank in the country collapsed and there was a bank run on the third bank, First Investment Bank. The majority owner of CCB had fled the country, allegedly stripping it of EUR 1 bln of liquidity. CCB was declared bankrupt in October 2014, after four months of special supervision by the central bank.

<sup>32</sup> See for details: Институт за пазарна икономика.

In an intricate manner, the story emerged from the ways by which the public sector of the country is governed and resulted from the difficulties of the above discussed energy project.

CCB, originally a boutique-agent in settling debt between Bulgaria and the Russian Federation, was capitalized and grew three times for a period of three-four years (2008-2013) by political and personal-political means.

The utilization of political connections in banking rested upon a 10-year old institutional arrangement; in 2004 the coalition government of monarchist NDSV and MRF, decided to stop the privatization of state-owned enterprises: electricity, gas and tobacco monopoly along with Railways and a couple of military SOEs were suddenly believed so “important” that they were listed as enterprises that could only be privatized by an act of the parliament.

The rise of CCB began with the next coalition of Bulgaria Socialist Party (BSP), NDSV and MRF that governed Bulgaria between 2005 and 2009; and then it continued under the new government of GERB.<sup>33</sup> The engine of this growth was a series of GOB decisions, as principal of above mentioned NEK, BEH, the companies to serve Belene and “South Stream” to transfer their accounts to CCB. In fact, two Socialists and centre-left (that of GERB) GOBs have been driving this engine.

The owner of CCB – it should be noted that the bank is almost a sole proprietorship – had a hobby of financing individual politicians and political parties and, due to old ties, had invited as a minority shareholder the Russian Vnesh-Torg Bank. VTB was the agent of the other side of the debt-settlement deal with the Russian Federation. The bank obtained a heavy political weight which helped in both attracting private depositors (announcing, at times, above 8% on deposits, while the average was hovering around 3%) and over-competing everyone else as a custodian of future large, government-sponsored projects, mostly in the power sector, and sponsored by Russian state-owned firms like GASPROM or ROSATOM. Or at least, CCB hoped it will be servicing such projects and companies.

33 GERB is an abbreviation of “Grazhdani za Evropejsko Badeshte za Balgaria” of Citizens for European Future of Bulgaria, GERB is a member of the European People Party.

The prime CCB political helper in these efforts, coordinator of the above efforts to rechannel government accounts to the bank, was and still is the MRF's MP who in 2008 served as a senior GOB executive in an insignificant ministry and whose nomination in June 2013 triggered the protest against then incumbent government.

This political clout that helped CCB growing from one of the smallest to the fourth bank of the country had recently entered into an internal conflict between the owner and the political helper in April to early May 2014: the conflict was over the credits of the helper, controls over some former public enterprises privatized and partially owned by VTB (e.g. the ex-tobacco and telecommunications monopoly). The bleak prospect for prompt construction of the South Steam pipeline by GAZPROM and eventual closure of the project was also an important factor: CCB was the custodian bank for the project. The account of the pro-GAZPROM construction arm is owned by one of the sanctioned Russian subjects in relation to the annexation of Crimea. The design of the contracts and the pipeline construction procurement contradicts the EU law, and triggered penalties from the Commission in Brussels. The project seems to have been put on hold, while Bulgarian subcontractors of GAZPROM were hoped to bring in more cash into the CCB.

The risks associated with these projects and conflict forced the GOB to withdraw some of the SOE accounts from CCB. The conflict and spitting between the two CCB gentlemen hit the media fan, private depositors panicked, asked for their saving and caused a liquidity problem.<sup>34</sup>

It is now anybody's guess how deep the whole is: CCB's political connection meant that its projects and credits were allocated to non-competitive ventures. The incumbent GOB promises forensic audits report to be published by the end of 2015. However, CCB, because of the peculiar manner of its banking, had almost no exposure to other banks, especially foreign owned. When CCB was declared bankrupt

34 See greater details and statistics on the CCB case: K. Stanchev, *Reputation Matters: A Not-So-Typical June 2014 Bank Run in Bulgaria (A Public Choice Perspective)*, "4Liberty", 09.07.2014, <http://4liberty.eu/reputation-matters-a-not-so-typical-june-2014-bank-run-in-bulgaria-a-public-choice-perspective/> [02.10.2015].

and guaranteed depositors were paid by the Guarantee Fund, all these savings were redeposit in the system.

### **3. Instead of Conclusions: Impacts on the Political System**

The above description of Bulgaria-Russian energy project allows for some conclusions. By no means is the analysis sufficient for revealing undisputable causality links. But there are some common and repeated phenomena that deserve further attention, not only in the Bulgarian context.

It is obvious that the main promoters of Russian state-owned companies' interest were a handful number of individuals around Socialist party leaders like president Parvanov and ex-PM Stanishev. These few individuals, however, because of democratically determined posts and the coalition nature of the political establishment, were and still are able to mobilize lairs of government, the legislature and other political parties in the pursuit of same or similar objectives. Thus, not only has the BSP (which is an heir of the former Bulgarian Communist Party, a proud heir) been involved in the promotion of the said interests. The ex-king and his party, besides the reasonable power sector reform they initiated, managed to destroy its own prospect for success and launched Belene and oil pipeline projects that eventually put at risk the entire economy of the country. Irrespectively the fact that the Socialist pushed for South Stream in the first place and attempted an infringement of the EU jurisdiction under GAZPROM dictation, all other political parties tried their best to keep it afloat for about four-five years. The Belene project is around for already 35 years, while Burgas-Alexandroupoli pipeline, the least harmful project, has been in the responsibility domains of three ordinary cabinets and two caretaker governments.

Once projects were set in motion, the next set of government typically sustains those using similar techniques of miss-governance of public interest. Typical techniques are the lack of analysis of socio-economic impacts, lack of information and/or refusal to grant access to public information, exaggeration of possible benefits and purposeful misleading of the public opinion.



It is also obvious, that the country has an immune system. In all cases, irrespectively the difficulties the above listed ways of public mismanagement and deceive of voters were overcome by strong and reasonable public opinion, which provided needed analytical expertise and organized resistance to crony ideas.

Needless to say, the EU law and democratic tradition had played a key role in fixing challenges related to Russian state-owned companies' interests. Some specific regulatory and energy policies of the EU, like those to subsidize renewables, have added much complication to the system: but they did so only because the domestic political establishment made the system inefficient in the first place, and then further mismanaged the complications.

During the period in question, the EU was an important player in rehabilitating the mess created by the South Stream project. But has, and could not have, any impact on the tacit connections between Bulgarian politicians and Russian company interests and politicians.

In the background of Mr. Stanishev as PM there was an interesting experience: he had run the country during its first two years in the EU. His image, however, soon suffered from alleged crony deals and nepotism related to EU subsidies when he attempted to cover up some irregularities of his administration. In order to overcome difficulties, he called an international advisory group to help improve Bulgaria's public governance, on the eve of the general elections of 2009.

The group was led by Dominique DeVillepin, and included experience politicians like Paul Demaret, Josep Pique, Aunus Salmi, Antonio Vitorino, and Casimir de Dalmau. The group worked in Bulgaria in April 2009 and delivered a report that made several key points about links between Bulgaria and Russian political establishments.

It mentions that Bulgaria-Russia relations, and underlines that: "it is particularly important for the EU to be able to rely on all its Eastern members when trying to develop a constructive approach towards Russia. On the other hand, a situation where some of these countries would fall again under strong Russian influence could cause a rift among EU members and need to be avoided."<sup>35</sup>

35 D. DeVillepin et. al., *Bulgaria in the EU: Building a New Partnership*, May 2009, p. 104. The report is not available on the Internet, and it was not disseminated by the PM of Bulgaria who invited.

Mr. Stanishev has hid the report from the public. As a sponsor of the cabinet of Mr. Oresharski in 2013, his fellow MP, in relation to South Stream attempted exactly this – a rift among EU members.

For those who are familiar with the history of Bulgaria, the reviews experience should be additional evidence disavowing the myths about Bulgaria being a “close ally of Russia.”

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