

STATE CAPTURE:

STATE CAPTURE IN EXTRACTIVE INDUSTRY BASED ON THE CASE STUDY OF BIRAČ

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Executive summary

This report investigates state capture in Republika Srpska (**RS**), in Bosnia and Herzegovina (**BiH**), through a case study of the process of privatisation, and subsequent illegal extraction of capital, within the extractive industries sector. More precisely, the case study is a company that is of strategic interest to a state, the alumina factory Birač, a joint stock company [*Bosnian: Tvornica glinice Birač akcionarsko društvo*] (**Birač**). The focus of the study is on those actors and mechanisms of governance through **which a system, or parts of a system, are appropriated by powerful individuals, groups or networks to favour their own interests.**

Birač, once the biggest manufacturing export company in all the former Yugoslavia, was privatised in 2001 under a special government programme. Ukio Investment Group, which is owned by Vladimir Romanov, bought the factory for Bosnia and Herzegovina convertible mark (BAM) 10 million, even though there was a clear conflict of interest, as it was the sole adviser to the government during the process of preparing Birač for privatisation. Despite committing to invest significant funds and to keep the workers, the Lithuanian investor used its influence and connections with the government not only to extract funds from the company through its “sister companies”, and to evade the payment of taxes, but also to gain additional subsidies and benefits from the government. Certain key actors, i.e. all the ruling governments and relevant authorities over the specified period over the course of 20 years, were involved in this form of looting, ensuring that Birač fell under the control of the Lithuanian investor. Thus, the case of Birač provides a textbook example of conflict of interest and abuse of power, position and personal and official connections.

Over a period of more than a decade, support from local players continued, with the granting of all possible subsidies and loans to the capturers. Unlawful practices were swept under the rug, with no questions raised during these processes. The key actors were different authorities over the course of 20 years, including the executive, the judiciary, the tax authority and the banking authority. Collectively, these actors ensured systematic and structural state capture, inflicting significant social and economic harm. Birač generated liabilities towards the tax authorities of RS and public companies in RS and BiH estimated at tens of millions of convertible marks. At the same time, the Lithuanian corporation used a variety of methods to extract money from the company and to transfer the money to offshore accounts in the British Virgin Islands and American Virgin Islands, leaving RS with only debts and outflows of vast amounts of untaxed money. They used transfer pricing methods to extract money legally, abused the capital market by

issuing worthless securities, and resolved unpaid loans by selling them to affiliated companies. After extracting all the available funds and benefits, the company was prepared for bankruptcy.

This report suggests that capture produced numerous negative outcomes. After the bankruptcy proceedings began in April 2013, Birač's assets lost some BAM 730 million in value, and it is once again owned by the RS Government. Around 300 workers lost their jobs and another 1,000 workers in the factory and sister companies are facing an unknown future. It has been estimated that more than 20,000 persons have been harmed by these actions, including the 3,000 shareholders of Birač and 17,000 shareholders of Balkan Investment funds, with damages amounting to €1 billion¹ and €700 million.² In addition to the direct harm that is measurable in monetary terms, there is indirect harm, which is far more widespread. The controlling institutions of the country have been destroyed, the trust of the entire population in the banking system (one of the most regulated systems in the country) has been destroyed, alongside its trust in the capital market and the institutions of RS entity, resulting in the utter mockery of the banking and accounting regulations of the entity. In addition, the Birač case has had a detrimental effect on future foreign investments, discouraging any serious investors from investing in the country.

Several policy areas have been identified as making the entire extractive industries sector “conducive” to capture: (1) privatisation of a state-owned company; (ii) tax policy and financial outflows by way of transfer prices; (iii) financial market regulators oversight (i.e. the lack of it) (banking agency, Securities Commission, Ministry of Finances, tax authorities); and (iv) judicial dependency. This study reveals that **capture practices are enabled and supported by existing legal and institutional frameworks**, and that these practices were developed in the interaction between our identified agents of capture and all governments over time. The **formal aspects of governance**, i.e. existing laws, can become enablers that contribute to the development of informal practices and, in the end, contribute to capture and serve to undermine the declared purposes of measures to safeguard consolidated democracy. In particular, the key problem in the Birač case was the failure of the competent authorities to undertake timely actions to prevent the capture, and their interpretation of unlawful practices as being lawful, bending the rules as they deemed fit. This bending of the rules was the key modus operandi for the state capture in this case. One can infer that the competent authorities were involved in the commission of the crimes – the biggest looting in the recent

¹ Note: Transparency International takes “billion” to refer to one thousand million (1,000,000,000).

² Documentary on Romanov clan published by an online media Žurnal.ba, available at www.zurnal.info/novost/20898/pogledajte-dokumentarni-film-klan-romanov, published on 4 January 2018, accessed on 5 January 2018.

history of RS and BiH. They actively supported the capturers, being equal partners and becoming co-capturers, since the entire scheme could not have been performed without the omnipresent role of the local authorities. The local authorities not only ensured the benefits for the capturers and enabled the crime, but also ensured the criminals' impunity through the obstruction of any possible investigation or prosecution.

To prevent such practices being repeated, we propose three directions of possible actions: (i) a full-scope prosecution of all responsible persons, (ii) changes in the normative framework, and (iii) the setting up of better controlling mechanisms and more frequent and stricter controls, followed by the depoliticisation of the supervisory institutions.

Introduction

The purpose of this report is to describe and analyse formal and informal governance mechanisms, the interaction between those mechanisms and the relationships between actors implementing them that lead to the (state) capture in BiH in the high-risk sector concerned. The focus of the research is on governance practices and policy mechanisms in the selected high-risk extractive industries sector, concentrating on the case study of the infamous privatisation of the alumina factory Birač, encompassing the period from its privatisation up to the point of the factory's bankruptcy and the investors' withdrawal from the country. The period investigated, 1998 to the present day, has been chosen in order to provide a full and comprehensive overview of all actors, practices and mechanisms relevant to the "capturing" processes. The research reveals numerous forms of corruption, including a rigged privatisation process, tax-related corruption, and manipulation of transfer pricing, judicial corruption and the role of private actors in the context of state capture – the "most destructive" type of corruption.³

Following this short introduction, the following chapters will address the key concepts used in the research, attempting to give a comprehensive definition of the term "state capture", the methodology that was applied and the pertaining limitations. The body of the report will then make clear the relevance of the chosen sector and the key challenges in that sector, illustrating the harm caused by the detrimental effects of the state capture not only to the sector itself but also to the country as a whole. This will be followed by the case study, which provides evidence to support the points made in the preceding discussion. The case

³ See: Brooks, G., Walsh, D., Lewis, C. and Kim, H. (2013) *Preventing corruption: Investigation, enforcement, and governance*. London and New York: Palgrave Macmillan., p. 122.

study will cover the following: (i) the background context; (ii) transfer pricing and Birač's affiliated companies; (iii) the role of Balkan Investment Bank; (iv) fictive financing and the role of the Banking Agency of RS; (v) the role of the Investment Development Bank in fictive transactions and the crediting of Energolinija d.o.o.; and (vi) a dependent judiciary, and fictive, fraudulent and harmful contracts. The concluding chapter will summarise the key issues and provide a summary of the results. This will be followed by a set of recommendations primarily targeting change-agents and policy-makers.

Key concepts

Theoretical concept of "state capture"

Large-scale and systematic "state capture", which is the root of widespread corruption, is acquiring such proportions in BiH that it is undermining the success of its transition and all economic and institutional reforms. State capture, despite how frequently it takes place, does not have a single definition because it is used in different contexts and covers various types of phenomena. In some cases it is used as a term which has a specific definition, while in others its use is based on the common meanings of "capture".⁴ For the purpose of this research, the phenomenon of state capture can be defined as a set of processes and their outcomes whose final aim is the control of public resources and their manipulation for the benefit of a particular targeted individual interest or group interests.

State capture as a term was originally coined in 2000 by World Bank experts looking into transformation processes in the context of the post-socialist societies of Eastern Europe and the former Soviet Union. Analysing the relationship between states and firms at the end of the 1990s, they observed that "after only a decade of transition, the fear of the leviathan state has been replaced by a new concern about powerful oligarchs who manipulate politicians, shape institutions and control the media," and who "shape the policymaking, regulatory and legal environments [...] to advance and protect their own enterprises at the expense of the social interest."⁵ In the "capture economy", as will be shown in this case study, the policy and legal environments are shaped to the captor firm's huge advantage, at the expense of the rest of the enterprise sector.

⁴ Centre for the Study of Democracy, State Capture Diagnostics Roadmap, Working Paper, August 2016, p 2., accessed on 20 December 2017., available at: www.csd.bg/fileSrc.php?id=23019

⁵ Joel S. Hellmann/ Geraint Jones/ Daniel Kaufmann "Seize the State, Seize the Day' State Capture, Corruption and Influence in Transition", World Bank September 2000; available at: <https://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-2444>.

The main challenge of countries in transition, such as BiH, has been to redefine how the state interacts with business and investors. However, little attention has been paid to the flip side of this relationship: how these companies, often owned and run by oligarchs operating both within and outside of the law, influence the state – and especially how they exert an influence on and collude with public officials to extract advantages. Some businesses and companies in transition economies have been able to shape the rules of the game to their own advantage, at considerable social cost, creating what Hellman, Jones and Kaufmann call a "capture economy" in many countries. In the capture economy, public officials and politicians privately sell underprovided public goods and a range of rent-generating advantages "a la carte" to individual firms.⁶ In order to achieve this, they distort democratic decision-making processes and policies, as well as the whole institutional set-up, which further leads to policy and institutional capture.

Thus, state capture can be defined as a systematic and well-organised process carried out by people with established relations. The focus is not on small-scale looting but on accessing and redirecting the country's resources away from their intended targets and into private hands. To succeed, it requires high-level political protection, including from the law enforcement authorities and judiciary, intense loyalty and a climate of fear, while all forms of criticism or competitors must be eliminated.⁷ The aim of state capture is to change the formal and informal rules of the game, legitimise them and select the players that are allowed to play.⁸ In other words, it is a system of corruption transactions (of different types and involving one or more public institutions) which ensure by default and over extended periods of time the privileged status of an actor in a given sector or area of activity.⁹

In conclusion, state capture, referring to a large-scale capture of all central government institutions, can be observed as an umbrella term that can be broken down into several different types (or scales) of capture, including the state capture itself, policy capture, tax policy capture and regulatory capture. The particular case study which is the focus of this report will be addressed in the light of these types of capture. Tax policy capture will be looked at in more detail because tax policy in RS is highly prone to capture because of the overly technical and complex nature of its governing legal framework, which, by default, is not

⁶ Joel S. Hellmann/ Geraint Jones/ Daniel Kaufmann "Seize the State, Seize the Day' State Capture, Corruption and Influence in Transition", World Bank September 2000; available at: <https://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-2444>.

⁷ H. Bhorat *et al.*, *Betrayal of the Promise: How South Africa is Being Stolen*. Published on May 2017, p. 5.

⁸ *Ibid.*

⁹ OECD (2017) „Preventing Policy Capture: Integrity in Public Decision Making“, OECD Public Governance Reviews, OECD Publishing Paris, p. 5 (available at: [http:// https://www.keepeek.com/Digital-Asset-Management/oecd/governance/preventing-policy-capture/no-country-is-immune-to-policy-capture_9789264065239-3-en#.Wlu8RbpFyP9](http://https://www.keepeek.com/Digital-Asset-Management/oecd/governance/preventing-policy-capture/no-country-is-immune-to-policy-capture_9789264065239-3-en#.Wlu8RbpFyP9)

transparent, either for the wider public or for other members of the captor network.¹⁰ Tax policy therefore creates a relatively wide scope for parliamentary and governmental discretion to insert loopholes and preferential treatment, and implementation allows for a wide scope of discretionary decisions favouring specific companies or individuals.¹¹ This can be achieved in two main ways: (i) by enacting preferential tax law and regulations allowing for "legal" tax evasion¹²; (ii) by evading tax collection and tax-code enforcement, which occurs when the captor group directly penetrates the tax authority, influencing how it collects taxes and who it audits. In the particular case at hand, "legal" tax evasion took place through the use of subsidiaries in tax havens and jurisdictions with high financial secrecy, combined with preferential tax deals.

Methodology

Considering the time constraints and the complexity of the subject matter, we endeavoured "to craft a minimally sufficient explanation of an outcome in a specific case" – or at least most of the outcomes – by means of qualitative research methods: a desk review of documents and media, and semi-structured interviews with the relevant informants.

The desk review covered local and national media reports and official documents, including audit reports, police and inspection reports, and court judgements and decisions, which made it possible to reconstruct contentious events and gain insight into the nature and mechanisms of "state" capture. Specifically, we reviewed: (i) official reports – Minutes of Executed Inspection Control of "Balkan Investment Bank" a.d. Banja Luka, number 06/2.2/431.2-66/13 of 17 December 2013; Report of the Ministry of Internal Affairs, Crime Police Department for Combating Organized Crime and Corruption, Unit for Combating Economic Crime, Financial Investigations and Money Laundering no 02/1-1-2 of 20 May 2014; the Minutes of Executed Inspection Control by Foreign Exchange Inspectorate, Ministry of Finances RS, number 06/2.2/431.2-66/13 of 17 December 2013; Judgement of District Court in Bijeljina no 59 0 Ps 026477 13 PS of 24 April 2017; audit report prepared by the auditing company Deloitte for 2011 of 7 May 2012; Global Financial Integrity "Illicit Financial Flows to and from Developing Countries: 2005–2014" as at April 2017;

¹⁰ Ibid p.45

¹¹ Ibid p.46

¹² EU Business, 2014, International Consortium of Investigative Journalists 2015

analysis of former Minister of Finance of RS Mrs Svetlana Cenić, “Birač –The Chronicles of One Privatisation” (a core piece for the research); and (ii) national media reports, in particular – Capital.ba as the most referenced and the most important media source, since it reported on the case from its beginnings, and *BUKA* magazine, as it published, when no other media has been reporting on the matter, the analysis of Mrs Cenić, as well as other media; and (iii) a number of academic articles on state capture and privatisation in post-communist countries and the Western Balkans discussing a state capture theory and privatisation. This desk review enabled us to build an initial overview of the problems and ill practices, and to analyse their role in the state capture. **Semi-structured** in-depth interviews with two relevant informants helped us to clarify elements from the desk-reviews. More precisely, the informants were former Minister of Finance, Mrs Svetlana Cenić, and the chief editor of renowned online media source Capital.ba, Mr Siniša Vukelić. The informants were chosen based on their expertise, reputations and the fact that they have been actively following the case for 17 years, which meant they were able to provide in-depth knowledge of the details of the case that might not otherwise have been available to us otherwise. These interviews were crucial for understanding the relations between key actors. The interviews took place in December 2017 and January 2018. The interviews were recorded, after obtaining consent from the interviewees, and transcribed, in whole or in part, for the purpose of analysis.

Regarding the **methodological limitations and shortcomings**, the most important of these was the time constraint, i.e. the research was time-limited, considering the complexity of the subject matter and the long period of time concerned (almost 20 years). In regard to a number of key actors, complex and obscure relationships and outcomes, more research time and access to official documents would be required in order to provide a clearer analytical picture of the key elements of capture.

Relevance of the sector and key problems

In general, the energy sector is one of the strongest economic sectors in BiH, with a long tradition and huge potential and opportunities for further development and investment. Although BiH has an abundance of energy resources, its policies and strategies have not been sufficient for the long-term planning of energy use. In fact, despite its energy potential, BiH is far behind its neighbours when it comes to the development of institutions and strategies in this area, as has been noted by the International Energy

Agency.¹³ One of the reasons for this is the detrimental political atmosphere and the abuse of the sector for private gain instead of for development and economic progress and to attract foreign investments. Birač was once the biggest manufacturing export companies in all of the former Yugoslavia and to this date it is still one of the largest economic giants in the Zvornik region, significantly affecting the growth of the industrial production and exports of RS and BiH as a whole. 6, 000 people in the Zvornik region and more widely directly or indirectly depend on Birač's business.¹⁴ As the company is of strategic interest and the energy sector itself is also of strategic interest the company has an enormous impact on the entire state economy and business development, and its capture has far-reaching consequences.¹⁵ The state capture of this sector and the company itself directly harms the RS budget, through channelling its funds and resources into the hands of dubious investors and through the extraction of enormous amounts of untaxed money by means of inadequate legal provisions on transfer prices, coupled with the scarce supervisory role of the competent supervisory bodies. State capture also directly threatens the livelihood of a huge number of employees and endangers a large number of shareholders. This results in an adverse effect on RS and on the entire economy. On a more abstract level, the capture of this sector jeopardises the core democratic institutions, it compromises the executive, judicial, tax authorities and law enforcement bodies, and it destroys the trust of citizens in the banking and financial sector.

“Birač” case study

(i) Background context

The Birač alumina factory was privatised in 2001 under a special government programme. Ukio Investment Group, owned by Vladimir Romanov¹⁶ bought the factory for BAM 10 million. The Group agreed to invest an additional BAM 50 million and to keep on the factory's workers. After bankruptcy proceedings began in April 2013, Birač's assets lost some BAM 730 million in value, and it is now once again owned by the *RS Government*. Around 300 workers lost their jobs and another 1,000 workers in the factory and its sister

¹³ N. Šunj, “The Root Cause of the Rebellion: Top Ten Privatization Plunders in Bosnia and Herzegovina”, 10 March 2014. Available at <https://bhprotestfiles.wordpress.com/2014/03/10/the-root-cause-of-the-rebellion-top-ten-privatisation-plunders-in-bh/>, accessed on 5 January 2018

¹⁴ Ibid.

¹⁵ Bayliss K. “Post-Conflict Privatisation: A Review of Developments in Serbia and Bosnia and Herzegovina”, Economic and Statistic Analysis Unit, ESAU Working Paper 12, Oversea Development Institute, London, 2005, accessed 21 December 2017. Available at www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/2519.pdf

¹⁶ The connection that brought Romanov to RS was allegedly the mother-in-law of the prime minister of RS at the time, Mr Milorad Dodik, Mrs Gordana Rašeta Blažić. Her husband worked for years in Russia and that is how they were connected and how the Romanov cartel entered RS and consumed the entire governmental structure.

companies are facing an unknown future. However, the story is far more complex and goes all the way back to 1998.¹⁷

On **28 February 1998**, former director of Birač, Vojin Grković, without the official approval of the Management Board of Birač (the *Management*), executed an Agreement on the Engagement of Ukio Bankas Investment Group (UBIG), an umbrella organisation for all of Romanov's activities, as a consultant (*Consultant*) in the privatisation process of Birač. The RS Government, headed by Milorad Dodik, granted a subsequent approval on **8 December 1998**¹⁸ for the engagement of Ukio Bank as a consultant for the preparation of the initial balance sheet and other supporting documents required for the privatisation of the state capital in Birač, for an overestimated fee of US\$149,000 (according to experts, the consultancy fees for such programmes in RS at that time were worth around BAM 10,000). The Management, on **4 August 1999**, adopted a privatisation proposal prepared by the Consultant, i.e. Ukio group, and submitted it to the Privatisation Directorate (*Directorate*) for evaluation.¹⁹

On **23 November 2000**, the tender for the sale of the state capital in Birač was announced and the most favourable bidder was chosen for execution of the sale and purchase agreement for 64% of the state capital, in the amount of BAM 456 million. Surprisingly, Ukio Bank, the Consultant, was one of the three bidders and it was the only bidder to fulfil the formal requirements, whereas the other two failed to make a deposit, enclose banking guarantees and provide a business plan, resulting in declaration of their bids to be void. The commission evaluated the only formally correct bid and awarded the Ukio Investment Group with the tender on **17 April 2001**.

The process of privatisation was, therefore, characterised by irregularities from its very beginning, considering that it was an obvious case of a conflict of interest, since the consultant in charge of preparing the privatisation was also a buyer in a privatisation process, and, conveniently, the two other bidders failed to meet the set requirements.²⁰ This was a unique example of a buyer advising the seller on how to sell the company while charging for its services.

¹⁷ N. Šunji, "The Root Cause of the Rebellion: Top Ten Privatization Plunders in Bosnia and Herzegovina", 10 March 2014. Available at <https://bhprotestfiles.wordpress.com/2014/03/10/the-root-cause-of-the-rebellion-top-ten-privatisation-plunders-in-bh/>, accessed on 5 January 2018.

¹⁸ Minutes of Executed Inspection Control of "Balkan Investment Bank" a.d. Banja Luka, number 06/2.2/431.2-66/13 of 17 December 2013. Available at www.capital.ba/ekskluzivno-litvanci-pljackali-vlast-pomagala-ij/, accessed on 11 October 2017.

¹⁹ S. Cenić: "Birač – The Chronicles of One Privatisation", published on 21 October 2013, available at ([/www.6yka.com/novost/%204404/birac-hronika-jedne-privatizacije](http://www.6yka.com/novost/%204404/birac-hronika-jedne-privatizacije)), accessed on 11 October 2017.

²⁰ Ibid.

Moreover, the privatisation was conducted contrary to the applicable privatisation laws, the instructions of the Ministry of Finances of RS and the regulations of the RS Government, resulting in numerous unlawful practices. For example, the evaluation of tender bids should have been performed in accordance with the Instruction on the Procedure and Method of Tender Evaluation with Variable Conditions, whereas the Directorate issued these instructions three months after the tender closed and five days prior to awarding the tender to UBIG, suggesting that there was no proper evaluation of the bids²¹. In addition to this, the buyer was not a strategic partner and did not meet the requirements prescribed by the applicable privatisation laws at the time. According applicable legislation, only a partner fulfilling the following two requirements can be considered as a partner of Birač: (i) the partner requires large quantities of alumina for its production; and (ii) the partner wants to invest in alumina production (i.e. is a strategic partner). These would be the only guarantees for enabling the production despite the low alumina prices since Birač would be able to survive only if it was bought by a financially strong strategic company.²²

However, the irregularities do not end here. The Privatisation Directorate was obliged to execute the sale and purchase agreement within three days of receipt of the notification from the tender commission, as set out in Articles 85 to 87²³ of the Rules on Tender Sale²⁴ – on **22 April 2001** at the latest. However, the agreement was not executed until **4 October 2001** and was subsequently amended three times, in December 2001 and May 2003, and on 30 December 2003, at the request of the buyer, completely changing the initial text of the agreement. The reason behind stalling the execution of the contract and the amendments was an intent to postpone the start of production since the price of alumina on the stock exchange was between US\$150 and US\$175 dollars per tonne. Production could be organised at this price only by a strategic partner, who would have to compensate for losses. Considering that the buyer failed to meet the criteria of a strategic partner, they stopped the production and sought government assistance to overcome the crisis. The buyer forced the RS Government three times to amend the arrangements, which provided the buyer with tremendous privileges in terms of the debt repayment.²⁵ These games lasted for two and a half years until the alumina price increased to a point which would make the profit possible,

²¹ Ibid. p. 5

²² Ibid., p. 3

²³ Article 86: "The negotiation to execute an agreement cannot be longer than 30 days as of the receipt of the invitation to negotiate. Exceptionally, at the proposal of the negotiation team, Directorate can extend this deadline." Article 87: "Directorate shall invite the winner of tender to execute the agreement at latest three days after the negotiation."

²⁴ Rules on Tender Sale (Official Gazette of Republika Srpska 24/98, 62/02, 38/03,65/03) – repealed regulation.

²⁵ S. Cenić: "Birač – The Chronicles of One Privatisation", 21 October 2013, available at (www.6yka.com/novost/%204404/birac-hronika-jedne-privatizacije), accessed 11 October 2017, p. 6.

when production abruptly restarted. The purchase price of BAM 10.25 million had a payment deadline of 25 days after the execution of the agreement. BAM 3 million and a deposit of BAM 250, 000 that had been paid earlier were included in the purchase price and the buyer committed to paying the remaining BAM 7 million within 90 days of the entry of the agreement into force. The agreement was signed with the RS Government, and the prime minister at the time, Mladen Ivanić, executed it.²⁶ However, the gravity of the “mistake” was best demonstrated by the fact that the Lithuanian investor was allowed to take over the company without paying the entire price, and to assume the ownership and management without meeting the requirements set in the agreement. Instead of investing in the overhaul of its own funds, the buyer took loans at Birač’s expense, meaning that the new management, despite its lack of ownership, managed to increase Birač’s debt.²⁷ The bottom line is that the RS Government repaid all the debts on behalf of the buyer, which were far more than what the buyer paid to the seller for the state capital in Birač.²⁸

(ii) **Transfer pricing and Birač’s affiliated companies**

The enabler that facilitated the takeover of a large part of Birač’s resources on the part of Romanov and those holding executive power was the applicable transfer prices legislation. The transfer prices had a severe effect on the economy as a whole, causing the financial collapse of a number of companies and undermining the state/entity budget through the loss of profit tax and VAT. Experts point to several forms of money outflows to tax heavens across the globe. Of these, the most commonly used scheme in BiH is to agree on different price of the goods as opposed to the set stock exchange prices – as took place in the case of Birač.²⁹ There is no official information on how much money was extracted this way; however, the American non-governmental organisation Global Financial Integrity recently published information showing that at least US\$8.36 billion has been extracted from BiH through illicit financial outflows in the past 10 years. BiH was ranked 57 out of 143 world countries with an average annual outflow of US\$386 million.³⁰ Having said this, the domestic legislation does not regulate transfer pricing adequately and the country does not have appropriate mechanisms to stop these outflows.

²⁶ “With the Help of the Government, Lithuanians Took Us for BAM 210 million”, 6 August 2014, available at www.rtvbn.com/314135/Uz-pomoc-vlasti-Litvanci-nam-uzeli-210-miliona), accessed on 11 October 2017.

²⁷ “How was Alumina Factory Privatized“, published on 11 November 2013, available at www.glassrpske.com/novosti/vijesti_dana/Kako-je-privatizovana-Fabrika-glinice-iz-Zvornika-III-Smanjene-milionske-obaveze-Litvanaca/lat/138917.html, accessed on 3 January 2018.

²⁸ Ibid.

²⁹ P. Klincov “Hundreds of Millions have been Extracted from BiH to Tax Heavens“, published on 15 April 2013, available at www.nezavisne.com/ekonomija/analize/Iz-BiH-se-stotine-miliona-iznose-u-poreska-utocista/188403, accessed on 15 January 2018.

³⁰ Global Financial Integrity, “Illicit Financial Flows to and from Developing Countries: 2005–2014“, April 2017, available at www.gfintegrity.org/wp-content/uploads/2017/05/GFI-IFF-Report-2017_final.pdf, accessed on 15 January 2018.

Examples of these financial outflows are numerous in the Birač case and have been questioned by the public and the media intensively, as will be described here in order to illustrate the formal and informal capture mechanism used by political and business elites in RS.

For the purposes of understanding the context, it is necessary to present, in summary, the corporate structure of Birač, and to present as regards the entire scheme as regards transfer pricing. During 2003 Birač performed corporate status changes by establishing new, separate legal entities as affiliated companies with 100% equity in their share capital, as follows: (i) Alumina d.o.o. Zvornik; (ii) Mehanika d.o.o. Zvornik; (iii) Birač-Energo d.o.o. Zvornik; (iv) AB "Birač-Europe" Lithuania; and (v) Energolinija Zvornik (indirectly).³¹

Birač's main business activity was production of alumina, among other products. It is important to mention the applicable privatisation law at the time and the sale and purchase agreement of the company explicitly prescribed that the company must not alter its existing main business activity for at least three years, uninterrupted.³² However, from **November 2001 to July 2003** the production process was terminated, while in **July 2003** an agreement was executed with the legal entity based in RS to perform the services of the processing of raw materials into finished products. From that point, the *main business activity* of the company was "holding affairs, shared functions, management and financing of affiliates, their strategic goals determination and basic strategies, tracking business and decision regarding their status".³³ This constituted a direct breach of the applicable legislation and an agreement, enabling the transfer of the main activity to the affiliated companies. The first company the Lithuanian investor established was "Balkal" a.d. Banja Luka (*Balkal*), on **12 December 2002**.³⁴ It had only two employees: the director Ratko Marčeta and the secretary. It was located at the rented premises of the Balkan Investment Bank, with the entire property consisting of several old computers and one old car, but it was at that time the third largest exporter of alumina in the country, exporting 100,000 million tonnes per year, just after Elektroprivreda and Aluminium Mostar – and yet it failed to settle accumulated VAT liabilities amounting to BAM 1,735,133.³⁵

³¹ Ibid.

³² Article 7 of Privatisation of the State Capital in the Companies Act (Official Gazette of RS 51 /06, 1/07, 53/07, 41/08, 58/09, 79/11, 28/13)

³³ Audit Report prepared by auditing company Deloitte for 2011 published on 7 May 2012, Banja Luka p.10

³⁴ „With the Help of the Government, Lithuanians Took Us BAM 210 million“ available at(<http://www.rtvbn.com/314135/Uz-pomoc-vlasti-Litvancinam-uzeli-210-miliona>), published on 6 8 2014, accessed on 11 October 2017

³⁵ Interviewee Mr Siniša Vukelić, chief editor of Capital. ba, interview held on 22 December 2017 in Banja Luka.

On 15 May 2003 Marčeta sold the company to “Corp System Ltd”, with its registered corporate seat in Tortola in the British Virgin Islands, with the new founder registered in the commercial register, making it difficult to identify the real owners in the case of any future investigations.³⁶ From that point, Balkal sold processed alumina at much lower prices to one of the foreign companies of the Lithuanian, “Ukio Group”. This company sold this alumina on the world market at much higher prices (stock market prices), resulting in profits leaving RS. The inspector of the RS Tax Administration, Goran Tanasić, stated in the Minutes of Inspection, that money was being exported from RS through Balkal³⁷. Balkal reported unrealistic costs of processing and raw materials in the period from 2002 to 2005. There was an unrealistic increase in revenue, benefitting Birač, and at the expense of Balkal. The increase in the generation of the higher prices of products sold by Balkal resulted in it reporting higher processing costs.³⁸ What this means is that the processing price of services that Balkal invoiced to Birač did not represent the actual expense in the income statement, i.e. Balkal’s profit was decreased and Birač’s income was unrealistically increased. The aforementioned inspection report was prepared on 16 December 2005, but the case was covered up without any sanctions for the responsible companies for accumulated liabilities to the Tax Administration RS amounting to millions. Balkal continued working unimpeded up until 2011 when bankruptcy proceedings were initiated as a result of unsettled tax liabilities amounting to millions.³⁹

The main Balkal buyers in the period from 2009 were offshore companies “E-Way LLC”, in the American Virgin Islands, “Viewside Markets Inc.”, in the British Virgin Islands and “AB Kauno tiekimas Filialas” in Lithuania. These companies were, at the same time, the main raw materials importers.⁴⁰ In March 2009, Alumina (another affiliate with no employees at the time) started with the production and sale of finished products, the main international buyers of which were, again, Viewside Markets Inc. and AB Kauno tiekimas Filialas, as the most significant buyers. The connections between Ukio Bank, the offshore companies, Birač and the affiliated companies are illustrated below.

AB Kauno tiekimas Filialas was established in Kaunaus, Lithuania, with dozens of employees, some of whom were responsible persons in Birač and affiliated companies, as well as "Industrija Adrija" Sarajevo,

³⁶ „With the Help of the Government, Lithuanians Took Us BAM 210 million“ available at (<http://www.rtvbn.com/314135/Uz-pomoc-vlasti-Litvanci-nam-uzeli-210-miliona>), published on 6 8 2014, accessed on 11 October 2017

³⁷ Minutes of Executed Inspection Control of „Balkan Investment Bank“ a.d. Banja Luka, number 06/2.2/431.2-66/13 of 17 December 2013, available at <http://www.capital.ba/ekskluzivno-litvanci-pljackali-vlast-pomagala-i/>, accessed on 11 October 2017.

³⁸ Ibid

³⁹ Minutes of Executed Inspection Control of “Balkan Investment Bank” a.d. Banja Luka, number 06/2.2/431.2-66/13 of 17 December 2013, available at www.capital.ba/ekskluzivno-litvanci-pljackali-vlast-pomagala-i/, accessed on 11 October 2017.

⁴⁰ Ibid.

and they also presented themselves as responsible persons of 'Viewside Markets Inc. and E-Way LLC. The company E-Way LLC was established in 2003 in the American Virgin Islands, without employees or income, and officially without a responsible person, with an opened non-resident's account in Ukio Bank. The company Viewside Markets Inc. was established in 2006 in the British Virgin Islands, without employees or incomes, and officially without a responsible person, with a non-resident account in Ukio Bank. The modus operandi of the aforementioned companies was something like this: in the sales office of Alumina d.o.o. in Zvornik, outbound invoices were produced for the former suppliers, and in one of the offices of Alumina the corresponding invoices were produced for Viewside Markets Inc. and AB Kauno tiekimas Filialas. The employees of Birač and Alumina were in the possession of the two aforementioned companies, which were obtained from Viktoras Zarevičius, employed by Birač. Furthermore, employees of Birač and Alumina signed the invoices of Viewside Markets Inc. on their own, at the orders of Mr Atanas Susic, one of the directors of the controlled legal entities, while the signature for AB Kauno tiekimas Filialas was provided electronically. The price orders towards the end-users entered in the invoices of " Viewside Markets Inc." and "AB Kauno tiekimas Filialas", were dictated by AB Kauno tiekimas Filialas, Lithuania, and for "Viewside Markets Inc AB Kauno tiekimas Filialas ", were often given by Oksana Kovtun, a member of the board of directors Birač, or deputy director of AB Kauno tiekimas Filialas, and Egle Vadopaliene. These invoices, with the prepared form for customs clearance (Birač a.d has its own shipment), were handed over to drivers, who would replace them upon departure from BiH (Bos trade forwarder, Loznica).⁴¹ Total earnings earned through the "mediation" in the period 2010–2012, based on the export of finished products by AB Kauno tiekimas Filialas to Lithuania, were €11,373,817.93. The commission for Viewside Markets Inc. for the period from 1 January 2011 until 3 September 2011 amounted to €3,028,137,93, thus making a sum of €14,401,955.86.⁴² The total "commissions" of the abovementioned "brokers" remained on these accounts at Ukio Bank in Lithuania.⁴³

a. The role of Balkan Investment Bank

The genesis of the Birač problem, and that of its affiliated companies, is directly connected to the establishment of the Balkan Investment Bank (**BIB**). BIB was established upon the arrival of the Lithuanian investors, as a support to the Birač, business and it was used as the extended hand of the real owner of all

⁴¹ Minutes of Executed Inspection Control of "Balkan Investment Bank" a.d. Banja Luka, number 06/2.2/431.2-66/13 of 17 December 2013, available at www.capital.ba/ekskluzivno-litvanci-pljackali-vlast-pomagala-i/, accessed on 11 October 2017.

⁴² Ibid.

⁴³ Ibid.

the assets of the Ukio group, of Romanov and of the UBIG Corporation. The Lithuanian bank Ukio Bankas and the Ukio Investment Group established BIB on **4 February 2000** and the Lithuanian investors managed BIB until its downfall in 2013, when RS took over the bank in the process of recapitalisation, Banka Srpske. Banka Srpske was also subsequently liquidated and its operations were also placed under investigation by state-level authorities.⁴⁴

BIB was the main financial service of UBIG Corporation. It was established with the prescribed minimal share capital as prescribed by the Banks Act of RS and relevant RS Banking Agency Decisions (**ABRS**), but all this capital was merely "transitory capital", as it was immediately carried out upon establishment, in the form of granting loans to non-resident legal entities registered abroad, without any substantial collateral for the Bank.⁴⁵ Only during Dodik's government did BIB transfer abroad approximately BAM 60 million (this refers only to non-resident loans), while the Bank's share capital amounted to a mere BAM 27 million.⁴⁶ Money was directly transferred to affiliated companies that were linked to BIB and Romanov. Conveniently, these affiliated companies were established in tax havens, with no possibility of determining their ownership structure. For example, some of the non-residents to whom enormous loans were granted by the BIB at that time were AB Kauno Tiekimas Filialas Company (Lithuania), with a loan in the amount of €3,850,000,00, with some railway in Lithuania as collateral. Incomplex LLC, with headquarters in a Native American reservation in the USA, was granted a loan in the amount of €3,500,000, 00, while providing bills of exchange issued in RS and certified by that USA company as collateral. The ENSCO 165 Company of Scotland was granted a loan in the amount of €380,000.00, pledging jerseys and souvenirs shops in Scotland as collateral. The Balkanika Company, registered in Brčko, was granted a loan in the amount of BAM 7,600,000.00, without providing a collateral. The company used this money to buy shares and used them subsequently as collateral for the loan.⁴⁷ All of these non-resident companies were directly or indirectly under Romanov's ownership, although they were located in different countries, and even continents, representing affiliated companies.⁴⁸ The key player in this endeavour of placements and money transfers of affiliated companies was a Lithuanian, Edvinas Navickas, the BIB director. According to an article written by a former RS president, Dragan Cavic, people who have collaborated with Navickas claim

⁴⁴ D. Čavić, DP president "Dossier: Not only 'Birač' failed but Balkan Investment Bank did as well!", published on 4 April, 2013, available at <http://slobodanvaskovic.blogspot.ba/2013/04/dosje-nije-samo-birac-propao-propala-je.html>, accessed on 6 October 2017.

⁴⁵ Ibid.

⁴⁶ Ibid.

⁴⁷ D. Čavić, DP president "Dossier: Not only 'Birač' failed but Balkan Investment Bank did as well!", published on 4 April 2013, available at <http://slobodanvaskovic.blogspot.ba/2013/04/dosje-nije-samo-birac-propao-propala-je.html>, accessed on 6 October 2017.

⁴⁸ Ibid.

that he was in the possession of all of the stamps of affiliated non-resident companies, with headquarters across the globe, which he would use to certify whatever was necessary to obtain these transfers.⁴⁹ In addition to loan placements abroad, with dubious collateral (to say at least), BIB exported money in other ways: e.g. through the purchase of shares in Lithuanian companies with no business history, or through the purchase of office buildings in Lithuania that was partially reinvested in the Bank through a share capital increase (in 2008, for an additional BAM 9 million). Two years ago, the State Investigation and Protection Agency (**SIPA**) started to investigate BIB as part of the ongoing investigation of the Birač case. Only after Capital.ba published the minutes of the Inspectorate on the wrongdoings in this bank did the competent authorities start questioning the responsibility of the director Banking Agency of RS, Mrs Slavica Injac, who, as the banking regulator, knew – or ought to have known – regarding what was going on. Also, the responsibility of Mrs Mira Bjelac, a former chairman of Credit Committee at BIB, was raised – but this did not prevent her from later becoming the chairwoman of the Management Board of the Banking Agency of RS.⁵⁰

b. Fictive financing and the role of ABRS

The Report of the Foreign Exchange Inspectorate⁵¹ (**Inspectorate**) describes in detail the fraud regarding the fictive share capital increase of BIB amounting to an incredible BAM 15.2 million and fictive shares transactions with the aim of extracting capital from this bank. The Report reveals the irregularities in the work of ABRS going back years. The share capital increase was just another method to cover up enormous credits risks assumed by placing loans to the affiliated companies and inadequate share capital, with ABRS approving all the unlawful actions by turning a blind eye to obvious breaches of the law and illicit undertakings. For example, on **22 December 2006** ABRS allowed the company UAB Asocijuoto Turto Valdymas to acquire 10 per cent out of 33 per cent of the BIB share capital. The Report states that ABRS failed to dispute the share capital increase by the offshore companies Bellgrad LLC USD and Capital Link USD, established in the Virgin Islands, which obviously did not use their own funds for the share capital increase of the bank. ABRS was legally obliged to assess the business reputation and financial status of

⁴⁹ Ibid.

⁵⁰ Capital. Ba “How Birač’s debt toward the Ukio bank was created”, published on 11 February 2016, www.capital.ba/nikad-otkriveni-detalji-milionske-prevare-kako-je-stvoren-dug-fabrike-birac-prema-ukio-banci-iv, accessed on 15 October 2017. www.frontslobode.ba/vijesti/ekonomija/76370/capital-sipa-otvorila-istragu-o-balkan-investment-banci, published on 13 April 2016, accessed on 11 October 2017

⁵¹ Minutes of Executed Inspection Control of “Balkan Investment Bank” a.d. Banja Luka, number 06/2.2/431.2-66/13 of 17 December 2013, available at www.capital.ba/ekskluzivno-litvanci-pljackali-vlast-pomagala-i/, accessed on 11 October 2017.

these companies and based on that assessment to decide whether to approve the acquisition of a significant ownership part in BIB. However, it allowed a suspicious company registered in a tax haven to increase its ownership share in the share capital in BIB. The Inspectorate infers that this “share capital increase” in 2008 served as a fictive increase of the share capital in order to increase the maximum credit that could be extended towards BIB’s clients. This claim is supported by the fact that the money paid in for this purpose was transferred to Ukio Bankas accounts in the amount of BAM 2,303,968, contrary to the valid legal provisions of RS. Once the fictive share capital increase was executed, the share capital of the Bank amounted to BAM 27 million, and it was fictively increased by BAM 15,207,368.

The inspectors, among other things, discovered irregularities in the payment transactions of the group of affiliated companies gathered around Birač, supported by sophisticated BIB logistics and Lithuanian Ukio Bank. By setting up a BIB by this bank, Ukio's non-resident accounts were opened in euros. On the other hand, all affiliated companies, registered in RS and BiH (Alumina, Mehanika, Energolinija, Balkal and Balkanika), opened non-resident accounts at Ukio banka in Lithuania. Thus, financial bridging began in the transactions between the aforementioned companies. The working technique consisted of payments being made by affiliated companies (based on the alumina business) to the non-resident accounts of these legal entities in Ukio Bank, while the other technique involved exchanging transactions between Ukio Bank and BIB. The purpose of the “exchange operations” was to transfer foreign exchange funds from non-resident accounts of Birač and Alumina to Ukio Bank to a non-resident account Ukio Bank in BIB, to be paid to the final creditors and suppliers of Birač and Alumina. This resulted in buyers’ money being withdrawn from the BiH accounts to accounts in Lithuania. The unlawful practices were reflected in the fact that non-resident accounts could not have been opened until 30 June 2006, when the RS Government rendered a Regulation on Conditions for Opening a Foreign Exchange Account Abroad. Hence, these transactions were contrary to the Foreign Exchange Act and the said Regulation. Therefore, these banks enabled, contrary to Article 38 of the Internal Payments Act,⁵² controlled legal entities to perform financial activities through a non-resident account under the terms of the long-term blockade of all resident accounts opened in the same bank, as well as other banks in BiH.

Furthermore, it was unambiguously established in the Report that the responsible persons in the controlled legal entities (Birač a.d. and all affiliated companies of Birač) during the period from 2004 up to the moment

⁵² Official Gazette of Republika Srpska nos. 52/2012, 92/12.

of control (April 2013), planned, organised and constantly reduced the assets of the mentioned legal entities by reducing the value of the exported goods, thereby selling below the market value of their finished products, leading to a decrease of capital and the understated value of the shares. They also concluded fictitious contracts with affiliated companies of a foreign company, on the basis of which they paid unfounded amounts of money, concealed the actual state of the business books, changed the name of the accounts in order to conceal the essence of the change, and made false documents and put them into their books, while at the same time avoiding paying their debts to domestic creditors (BAM 131,000,000.00), taxes and loans to the state, and in other ways losing their business partners – which led to bankruptcy.⁵³ It can be inferred that BIB, as of its establishment, was in matter of fact a vehicle for exporting the capital from RS, i.e. the money (deposits) of RS citizens was placed abroad in amounts exceeding the total amount of the share capital of the Bank.

c. The role of Investment Development Bank RS in fictive transactions and Energolinija d.o.o.

Despite the fact that Birač was heavily indebted towards the Tax Administration RS and public enterprises across BiH, it was a constant recipient of numerous state benefits and subsidies that, up to April 2013, amounted to BAM 38.8 million, which underlines our initial conclusion that the seller (RS) paid far more than the buyer of the company.⁵⁴

Regardless of the enormous debts and subsidies, the Investment Development Bank RS (**IRB RS**) granted two loans to one of the companies in the Birač Group, i.e. Energolinija d.o.o. Zvornik, which then was 100 per cent owned by Birač a.d. Zvornik, although the rules of the IRB RS prescribe that a legal person must have all its tax liability settled when applying for a loan.⁵⁵ The first loan, in the amount of BAM 5 million, was approved on **21 May 2009** through BIB. The second loan, in the amount of BAM 19.4 million, was approved on **10 May 2010**, directly without intermediaries, from the funds of the European Investment Bank. The funds obtained from the first IRB RS loan, in the amount of BAM 5 million, Energolinija transferred to affiliated companies based on fictitious invoices justifying the use of the loan. This means

⁵³ Minutes of Executed Inspection Control of “Balkan Investment Bank” a.d. Banja Luka, number 06/2.2/431.2-66/13 of 17 December 2013, available at www.capital.ba/ekskluzivno-litvanci-pljackali-vlast-pomagala-i/, accessed on 11 October 2017.

⁵⁴ “With the Help of the Government, Lithuanians Took Us for BAM 210 million”, published on 6 August 2014, available at www.rtvbn.com/314135/Uz-pomoc-vlasti-Litvanci-nam-uzeli-210-miliona, accessed on 11 October 2017.

⁵⁵ Minutes of Executed Inspection Control of “Balkan Investment Bank” a.d. Banja Luka, number 06/2.2/431.2-66/13 of 17 December 2013, available at www.capital.ba/ekskluzivno-litvanci-pljackali-vlast-pomagala-i/, accessed on 11 October 2017.

that Energolinija took a loan from IRB RS, and purchased equipment and real estate from another company in the Birač Group, which issued fictitious invoices justifying the used funds. The key problem was the fact that loans were not spent for the designated purpose. However, despite the fact that IRB RS stated that it was aware of this fact, it failed to act on it. The second loan was required for the purpose of starting a coal-fired power plant or for the replacement of an existing gas generator. It is indicative that there is a gas pipeline to the factory itself, while the coal had to be transported by rail because there was no appropriate site for coal nearby. Another important point is that at that time there were huge debts for spent gas that, as can be seen, the investors never intended to pay. The same could be said for the loan itself, since the plan from the beginning was to extract the funds to Romanov's affiliated companies because the investors were already intending to leave Birač and BiH.

It is interesting that this loan was first rejected, that and only a few months later a new request was submitted. Energolinija filed the first loan request, in the amount of BAM 19,476,650, 00, which was rejected on **22 December 2011** by the IRB RS Credit Committee. The very next day, the director of IRB RS at that time, Milenko Pavlović, resigned. On **19 January 2012** Energolinija requested a new loan, in the amount of BAM 19.4 million. IRB RS reported to the RS Government in writing that Energolinija was a very risky client and that the loan should not be approved. IRB RS warned the RS Government of the determined irregularities during the control of the previously granted funds for a loan of BAM 5 million, that the collateral was not sufficient for the required amount of the loan, and that IRB RS doubted the stated estimated value of the asset to be provided as a collateral.⁵⁶ The RS Government was well aware of all these facts, but the pressure on the IRB RS Credit Committee was enormous, and eventually it was necessary to make a decision to grant the loan. However, the Credit Committee of IRB RS, due to the fact that it was a highly suspicious and controversial placement, made a decision to approve only BAM 6 million, and the RS Government, as a Major Credit Committee of IRB RS, increased this amount to BAM 19.4 million. The moment this money was in Energolinija's account, it was transferred to accounts in tax havens (these investments were never justified by IRB RS, and from the bank transaction, it is obvious that the money was transferred outside of RS).⁵⁷ Furthermore, the loan granted to Energolinija by the European Investment Bank's credit line was extremely favourable, with a grace period of two years and an extremely

⁵⁶ Minutes of Executed Inspection Control of „Balkan Investment Bank“ a.d. Banja Luka, number 06/2.2/431.2-66/13 of 17 December 2013, available at <http://www.capital.ba/ekskluzivno-litvanci-pljackali-vlast-pomagala-i/>, accessed on 11 October 2017.

⁵⁷ Ibid.

low interest rate (4% per annum), but the Lithuanian investors did not bother paying interest rates during the grace period, i.e. no single instalment (including only interest costs) was paid to IRB RS.

Since the loan was approved by the European Investment Bank's credit line, it was subject to control by its representatives. Although at the beginning of the year the regional media announced that IRB RS would receive \$50 million from the European Investment Bank that has not yet happened, for obvious reasons. Hence, the indirect harm done to the RS economy is clear in the fact that it lost an extremely favourable credit line from the European Investment Bank.

Taking into the account only publicly available information, we calculate damages in the horrific amount of nearly BAM 210 million. It is surprising that the controlling bodies over the last nine years of Dodik's government did not prevent or sanction such a huge plunder. It is noteworthy to mention that BIB eventually collapsed, in 2013, and IRB RS and the Guarantee Fund of RS had to invest an estimated of BAM 30 million in its rescue, which proved to be unsuccessful in the end, as the Bank announced a loss of more than BAM 20 million in 2013 (according to the Independent Auditor's Report the real loss is considerably higher).⁵⁸ The bottom line is that the loan granted by IRB RS to Energolinija, as a result of pressure by the RS Government, ended up on the accounts of affiliated companies of Birač in Lithuania and was used for financing the "UAB Ukio bank investment group"⁵⁹ – Energolinija funded the Ukio Bank based on the loan agreement with BAM 3 million, failing to report those to the Ministry of Finances RS, severely breaching the Foreign Exchange Act of RS⁶⁰. On top of that, it is more than clear that the loan was not used for its designated purpose.

d. (In)dependent judiciary, and fictive, fraudulent and harmful contracts

Lastly, in order to provide a comprehensive summary of this case of state capture, the role of the judicial system must also be analysed – in this case, this system served as an enabler. In short, Ukio Bank tried to collect from Birač and Alumina fictive receivables of BAM 155 million for fictive debts and illegal collateral, with the help and support of local courts and judges who interpreted harmful contracts and fictive provisions in their favour. The Lithuanian investors, under the umbrella company "Europe Birač", took loans in the amount of €80 million in the name of Birač Zvornik in the period from 2003 to 2011. This amount

⁵⁸ Minutes of Executed Inspection Control of "Balkan Investment Bank" a.d. Banja Luka, number 06/2.2/431.2-66/13 of 17 December 2013, available at www.capital.ba/ekskluzivno-litvanci-pljackali-vlast-pomagala-i/, accessed on 11 October 2017.

⁵⁹ Ibid.

⁶⁰ Official Gazette of Republika Srpska nos. 96/03, 126/06, 92/09, 20/14

equalled the losses of four affiliated companies in Lithuania. In **December 2012**, the entire property of Birač, Alumina, Mehanika and Alusila, contrary to the relevant legislation in RS, was used as collateral for a contentious receivable of BAM 155 million. The moment Ukio Bank went bankrupt, they announced tender on Birač's debts of BAM 155 million, claiming the payment of receivables from Birač without any legal basis. Part of the debt, 10 per cent of the value, was bought by "Pavgord", owned by a notorious businessman Gordan Pavlović. This contract between Pavgord and Ukio Bank was null and void, with an ongoing procedure before the District Courts in Bijeljina and in Zvornik. However, the problem is that the District Court in Bijeljina rendered two opposite decisions in the same matter, which serves as an indication of potential ill practices. In the case of Alumina, it confirmed the decision of the Basic Court in Zvornik allowing Pavgord to switch positions with Ukio Bank, while in the case of Rudnik Srebrenica, it abolished the decision of the Basic Court and prevented Pavgord switching places with Ukio Bank, blocking it from collecting anything.⁶¹ The claims were the same, the legal grounds were the same, and the judgements of the Basic Courts in Zvornik and Srebrenica were identical, but the judgement of the District Court in Bijeljina was the opposite⁶². Pavgord illegally bought part of the receivable of **BAM 122 million for €6.4 million**. In order to convert illegal receivables into the share capital and to become a major owner of Birač, Pavlović needed the support of the courts. The key actors in this regard are Judge Slavica Tadić, the chairman of the Basic Court in Zvornik, acting Judge Jelena Todorović and Zoran Džido, Chairman of the District Court in Bijeljina. Judge Jelena Todorović promptly blocked the Alumina accounts in order to enable Pavgord to collect BAM 155 million, although Pavgord bought the receivable in the amount of BAM 122 million. Hence, she blocked, on her own initiative, BAM 33 million, without any legal grounds. Judge Todorović made this decision on the same day as the District Court in Banja Luka rendered an interim measure prohibiting the collection of the contentious receivable and despite the prohibition of the Constitutional Court BiH of a collection of the receivable from Alumina. The Constitutional Court BiH instructed the aforementioned courts to annul the said decision. The judges declined to act upon the decision of the higher court. This decision was unfounded, 1,400 employees are close to losing their jobs and 2,000 employees who are indirectly dependent on the company are also close to losing their jobs.

⁶¹"Because of the blockage, Alumina is collapsing", [published on 15 April 2017](http://www.capital.ba/zbog-blokade-racuna-alumina-pred-kolapsom/), available at www.capital.ba/zbog-blokade-racuna-alumina-pred-kolapsom/, accessed on 17 October 2017.

⁶² S Vasković "Parallel Judiciary System Džido Trangle", 30 May 2017, available at <http://slobodanvaskovic.blogspot.ba/2017/05/paraleni-pravosudni-sistem-dzidin-ugao.html>, accessed on 15 October 2017.

In short, the unlawfulness of the practice is reflected in the fact that Pavgord could not have bought off the receivables from Ukio Bank if the applicable Foreign Exchange Act of RS had been taken into account. Ukio Bank was not a resident and any foreign exchange transaction with foreign companies that are not residents must be reported to the Ministry of Finance, and require their approval in order to be legal. This was not the case.⁶³ The contract was not valid, it had a number of legal deficiencies, without legal grounds for a cession considering the aforementioned circumstances, implying that this contract was null and void, as stated in the analysis of the legal expert team of RS. However, what is worrying is the announcement by the Basic court of Bijeljina that it does not intend to unblock the company's accounts unless this is done by Gordan Pavlović. Having said this, it is evident with whom the (in)dependent judiciary has sided – leaving us with the conclusion that the key role of the judiciary in this case was to prevent any potential processing and prosecution of the key actors.

Against this background, the criminal scheme of the affiliated companies and offshore companies was investigated by the competent police authorities, and the tax inspection and prosecutor's office – but without the expected results. One of the interviewees, Mr Vukelić, stated that only three inspectors were assigned to this complex case, not one international warrant was issued and no concrete actions have been undertaken to pursue the responsible persons for the damages. In his opinion, this looks like another action by the Ministry of Internal Affairs RS in order to keep control over the prosecution and prevent its referral to the jurisdiction of **SIPA**, BiH Prosecutors' Office, and Court of BiH, where the RS officials would not be able to influence the entire process.⁶⁴ Against this background, it is important to compare this case with the case of Agrokomerc, in the former Yugoslavia: there the damages were estimated to be less than in the Birač case but 25 inspectors were assigned to the case, and worked for several months in order to document all of the criminal proceedings in the company as quickly as possible. It is possible to conclude that the competent authorities have refused to pursue this matter seriously, and we can infer that they are involved in the criminal organisation of the Birač looting.⁶⁵ In terms of the scheme of affiliated companies, the inspectors assumed that they had discovered only 30 per cent of all affiliated companies and offshore companies.⁶⁶ However, this complex financial scheme could not have been performed as smoothly without

⁶³ Đ. Kesić "The Devil in Zvornik – Part Two", published on 15 April 2017, available at www.pravda.rs/lat/2017/04/15/necastivi-u-zvorniku-drugi-deo/, accessed on 15 October 2017.

⁶⁴ Interviewee Mr Siniša Vukelić, chief editor of Capital. ba, interview held on 22 December 2017 in Banja Luka.

⁶⁵ Ibid.

⁶⁶ Ibid.

the financial logistics provided by Ukio Bank Lithuania and the establishment of **BIB in Banja Luka**, which assumed a crucial role in the entire process of extracting money from Birač.

Conclusions

This report has documented the systematic repurposing of state institutions in accordance with a political project mounted by the RS political elite and the Romanov cartel. It has been demonstrated that the purpose of this political project was systematic illegal activity. These pre-meditated and co-ordinated activities were designed to enrich a core group of beneficiaries, to consolidate political power and to ensure the long-term survival of the system that has been built up by this power elite over the past two decades. At the nexus of this symbiosis is Romanov and his core company Ukio, which is connected to all of the other actors. In conclusion, the goal of the overall business policy was as follows: (i) to constantly produce a loss in Birač with the aim of buying the rest of the shares at lower prices, or if that was not possible, reducing capital to reduce the number of shares of other shareholders; (ii) to take as much benefit as possible from the state, to use undesignated loans without repayment, and, if possible, to avoid paying taxes; (iii) to shift the loss to domestic creditors while ensuring at the same time that E-Way LLC, Viewside Markets Inc. and AB Kauno tiekimas Filialas generated profit and in the final stage only Viewside Markets Inc. and E-Way LLC; and (iv) to keep all of Birač's property encumbered by the said affiliated companies abroad for the purpose of securing their loans.⁶⁷ After the Romanov criminal organisation left the country and the entire Romanov "empire" collapsed throughout Europe, all that was left was their enormous debts to the RS, the indirect taxation authority and the huge number of public enterprises across RS and BiH, causing RS tremendous losses. It has been estimated that more than 20,000 persons have been harmed by these actions, including the 3,000 shareholders of Birač and 17,000 shareholders of Balkan Investment funds, with damages amounting to €1.7 billion.⁶⁸ The far-reaching direct harm impacts on all citizens of RS as a result of the budget looting, with its effects continuing through the acquisition of the bankrupted BIB by RS. RS took over the bank with all its assets and liabilities, meaning it primarily assumed the liabilities as there were no valuable assets left – thus, continuing to further invest RS citizens' money with the aim of covering up the full scale of the crime. Birač created liabilities towards the tax authorities of RS and public

⁶⁷ Đ. Kesić "The Devil in Zvornik – Part Two", published on 15 April 2017, available at www.pravda.rs/lat/2017/04/15/necastivi-u-zvorniku-drugi-deo/, accessed on 15 October 2017.

⁶⁸ Documentary on Romanov clan published by an online media source, Žurnal.ba, available at www.zurnal.info/novost/20898/pogledajte-dokumentarni-film-klan-romanov, published on 4 January 2018, accessed on 5 January 2018.

companies in RS and BiH, estimated in millions. In addition to the direct harm that is measurable in monetary terms, the indirect harm is even more widespread. The controlling institutions of the country were violated, resulting in the trust of the entire population in the banking system (one of the most regulated systems in the country) being eroded. Trust in the capital market and the institutions of RS have also been shattered, with a detrimental effect on foreign investments and with a combined final effect of seriously endangering the further development of democracy in RS.

Recommendations

Our recommendations include (but are not limited to) the following three main points:

- 1. Full-scope prosecution of all responsible persons, in the country and abroad, with sentences appropriate to the incurred damages.*

This will require political action within and outside of this symbiosis of politics, judiciary, tax authorities and law enforcement authorities, coupled with legal action to criminalise and bring the perpetrators of state capture to justice. Enforcement agencies should designate all of their resources to tearing down the entire structure, rather than only taking symbolic action (as has been the case up until now). This will also require bold action by the banking sector to expose and shut down the financial mechanisms that were used and to prevent this from happening again.

- 2. Changes to the legal framework – in particular, regarding transfer pricing.*

Domestic legislation fails to address transfer pricing adequately, resulting in huge money outflows from the county. It is necessary to provide appropriate mechanisms and controls that will prevent the former, as the current ones are not suitable to stop this process.

- 3. Establishing better controlling mechanisms, and more frequent and stricter controls, followed by the depoliticisation of the supervisory institutions*

The problem with the current mechanisms is the fact that external auditors who are in the control of transfer prices of affiliated companies can make their findings based on information and documents provided by the company's management and company's assembly. However, they cannot conduct investigations. For example, when an auditor receives information from a company regarding an affiliated company located in

the Bahamas, the auditor does not have the capacity to request the Bahamian authorities to provide information on that company – in particular, if the tight deadlines for auditing (between 30 and 60 days) are considered. Further on, an auditor attempting to prove transfer pricing needs to provide strong evidence in order to avoid a client's lawsuit regarding the protection of its inalienable right to do business with whomever it chooses and to sell the goods at the prices it wants.⁶⁹ Many auditors are of the opinion that subsequent control does not have any value, once the money has already been drained. Therefore, preventive mechanisms should be put in place, followed by the depoliticisation of core supervisory institutions, including auditors, tax authorities and the indirect taxation authority, ensuring their timely reaction and action when irregularities are spotted and brought to the light.

In conclusion, it is clear that state capture by power elites has profound implications for state institutions. It destroys public trust in the state and its organs, it weakens key financial agencies and it erodes confidence in the economy and the market. When there is no trust in public institutions there is little goodwill to express solidarity through payment of taxes, large companies are predisposed to sit on cash rather than reinvest profits towards productive use, criminality proliferates, exploiting weaknesses in intelligence and crime enforcement authorities, and both capital and skills flee the country. The majority of BiH's citizens bear the brunt of these corrosive developments. Worryingly, large-scale corruption enables much wider corrupt activities to go undetected in the lower tiers of government. Under such conditions, it is impossible to achieve those transformative objectives that could improve the livelihoods of the majority of BiH's citizens.

⁶⁹ Mr Goran Radivojac, professor at the School of Economics and certified auditor, in the online article www.nezavisne.com/ekonomija/analize/lz-BiH-se-stotine-miliona-iznose-u-poreska-utocista/188403, published 15 April 2013, accessed on 15 January 2018