

## Bulgarian-Russian games in the energy sector: an outcome is getting closer

Tomasz Dąborowski

**Bulgaria and Russia are entering the final phase of setting the conditions of their co-operation in the energy sector. A new gas contract is being negotiated because the currently applicable agreements will have expired by the end of this year. The fate of two major energy projects – whose implementation depends on good co-operation between Sofia and Moscow: the Burgas–Alexandroupolis oil pipeline and the construction of a Bulgarian nuclear power plant in Belene with Russian participation – is currently being decided. Another issue ever-present on the agenda is the future of the South Stream gas pipeline promoted by Russia, which is to run through Bulgarian territory. The outcome of all the aforementioned discussions and negotiations will determine for years the model of Bulgarian-Russian relations and may strongly affect the shape of the oil, gas and electricity markets in South-Eastern Europe.**

Bulgarian-Russian talks on co-operation in the energy sector are taking place in a confrontational atmosphere and have not brought about any binding results as yet. This lengthy deadlock in energy relations between the two countries is a consequence of a serious conflict of interests. Russian policy towards Bulgaria is dependent on Moscow's strategic goals: the desire to maintain its position of a key supplier of fuels to Europe and to enter the EU's nuclear energy market. Without Bulgaria, the implementation of the infrastructural projects which Russia has been pushing through in South-Eastern Europe would be challenged. In turn, Bulgaria is trying to capitalise on its strategic location and build more partnership-based relations with Russia and to benefit as much as possible from its participation in the projects put forward by Moscow. Therefore, it is interested in the implementation of large energy projects, but not at any price. Furthermore, improvement of gas security is becoming a matter of increasing priority for Bulgaria. It has become aware of its need to diversify the sources and routes of gas supply as a consequence of the gas crisis, which unfolded at the beginning of 2009.

The lack of consensus on the large-scale energy projects and the increasingly frequent friction seem to indicate that the 'rough friendship' between Russia and Bulgaria will probably be sustained. However, as regards the future of the large-scale energy projects, the most likely scenario is the one which sees the enhancement of co-operation between the two countries in the nuclear sector. This will increase Russia's role on the electric energy market in South-Eastern Europe. No change is expected in the existing bilateral co-operation in the oil sector. The future of the South Stream project is the most difficult to predict because of its vast scale and the fact that Russia and Bulgaria are not the only players on which it depends. Nevertheless, Bulgaria will gradually lessen its dependence on Russia in the gas sector. However, it will take few years before this happens.

## Bulgaria's energy dependence on Russia

Bulgaria has a relatively well-organised energy balance (see Appendix 1). The main source of its energy is coal (36%), followed by oil and petroleum products (a total of 24%), nuclear energy (21%), natural gas (12%) and renewable energy sources (6.5%). Almost all of its imported oil, natural gas and nuclear fuel originates from Russia. Furthermore, Russian companies are major players on the Bulgarian oil market, as well as important for gas and nuclear sector in Bulgaria.

Bulgaria imports natural gas (between 2.5 and 3 billion m<sup>3</sup> annually) only from Russia. Supplies are made with the agency of three companies: (a) the Russian-Bulgarian company, Overgas Inc. (50% Gazprom, 50% Overgas Holding, with a non-transparent ownership structure), which supplies approximately 2.5 billion m<sup>3</sup> of gas annually; (b) the Russian-German company, WIEE (50% Gazprom, 50% Wintershall), which supplies on average 0.5 billion m<sup>3</sup> of gas annually; and (c) Gazpromexport, which supplies small quantities of 'technical gas' for the needs of transit. Gazprom also has access to gas sales through Overgas Inc., which directly carries out approximately 10% of the supplies to end users in Bulgaria. The existing gas connections between Bulgaria and its neighbours – the interconnectors with Romania, Turkey, Greece and Macedonia – are elements of Bratstvo transit pipeline used to transport Russian gas.

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Bulgaria imports on average 8 million tonnes of oil and petroleum products annually. The vast majority of the imports comes from Russia (approximately 85%). The Russian corporation, LUKoil is the key player on the Bulgarian oil market, whose subsidiary (LUKoil Bulgaria) is one of the largest firms in Bulgaria. LUKoil controls Neftechim Burgas, the only refinery in

Bulgaria and the largest one in the Balkans (its annual capacity is 9.5 million tonnes of oil), and the Rosenets oil terminal (capable of receiving 10 million tonnes of oil annually). LUKoil also has a share of approximately 25% in the Bulgarian fuel sale market owing to the development of its filling station chain.

Russia also plays a major role in the Bulgarian nuclear sector. The Kozloduy nuclear power plant, the only one currently operating in the country, was built with the use of Russian technologies. Nuclear fuel is supplied by Russia's TWEL, which in 2006 extended the supply contract for the next 20 years. Russian companies are also participating in the construction of the new nuclear power plant in Belene. According to an initial agreement, Russia's Rosatom is to be among the shareholders of the new power plant. Additionally, Rosatom's subsidiary, Atomstroyexport (ASE), won a tender and signed in 2008 a contract to build Belene NPP.

## Bulgaria on the Russian energy policy map

Bulgaria, due to its strategic geographical location, is an important country to Russia. The southern branch of the transit gas pipeline, Bratstvo, which transports annually around 14 billion m<sup>3</sup> of gas to Turkey, around 3 billion m<sup>3</sup> to Greece and minor amounts to Macedonia, runs through Bulgarian territory. Thus transit via Bulgaria accounts for almost 15% of Russian gas exports to non-CIS countries. Three strategic – from Russia's point of view – energy projects, the South Stream (SS) gas pipeline, the Burgas–Alexandroupolis (BA) oil pipeline and the Belene nuclear power plant, are also located in Bulgaria (see Map). One of the aims of the SS and BA projects is to reduce Russia's dependence on other transit countries, Ukraine and Turkey. They also are an important tool used in Russian energy

policy abroad because promoting these projects is making the prospects for the completion of competitive projects more complicated, such as the Nabucco gas pipeline and the Constanta–Trieste or Odessa–Brody oil pipelines.

The Belene nuclear power plant project is important to Russia mainly for commercial reasons. The implementation of this investment will bring significant financial benefits to the Russian nuclear industry. The contracts signed with Russia's ASE alone is worth 4 billion euros, which is several times more than the estimated construction costs of the Bulgarian sections of the SS or BA pipelines. However, this investment can also be seen in a strategic context. This would be the first nuclear power plant to have been built from the ground up by Russia on the EU market since the 1990s (the nuclear power plants presently operating in Hungary, the Czech Republic and Slovakia were built with the use of Russian technologies in the 1980s). A failure of the Belene project would come as a serious blow to the Russian nuclear industry on the EU market and would significantly impede Russia's expansion into the electric energy market in South-Eastern Europe.

### A new vision for Bulgaria's energy policy?

Russian-Bulgarian relations have cooled significantly since the gas crisis at the beginning of 2009. They became even colder after the centre-right party, Citizens for European Development of Bulgaria (GERB), led by Boyko Borisov came to power in July 2009 partly because the prime minister announced the need to revise existing energy deals with Russia. The Borisov-led government proclaimed a discontinuation of the policy of their predecessor, the centre-left cabinet of Sergei Stanishev, who was a staunch supporter of enhancing Bulgarian-Russian energy co-operation. Despite the increasingly commonly seen friction in relations with Russia and the rhetoric being used by the ruling class in Bulgaria, it is still difficult to speak of a deep change in Bulgaria's energy policy. Firstly, the government is not withdrawing support for the Russian projects. Its policy is 'playing on many different pianos', i.e. offering support to all energy projects without being certain of which of them will be

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finally implemented. This policy is basically no different from the one the previous centre-left cabinet led by Sergei Stanishev was pursuing, as they officially supported not only the Russian projects but also the competitive projects for building the Nabucco gas pipeline or the AMBO (Bulgaria – Macedonia – Albania) oil pipeline. Secondly, the Borisov-led government,

like the preceding governments, supports the development of the nuclear energy sector. The national energy strategy adopted in early June 2011 (covering a timeframe until 2020) emphasises the need to extend the period of operation of the Kozloduy nuclear power plant (the two last reactors are to be decommissioned by the end of 2017 and 2019) and to increase the output of the nuclear energy sector by 2,000 MW. This is to be achieved either by building an additional two reactors at the Kozloduy power plant or the construction of a new power plant in Belene<sup>1</sup>.

However, the change which has taken place in Bulgaria's energy policy is the intensification of efforts to improve the country's gas security. Therefore, the turning point in Bulgarian energy policy happened not when the centre-right came to power but after the gas crisis at the beginning of 2009. The reserves released at that time were definitely insufficient to satisfy the demand for gas during the break in supplies from Russia, which lasted almost three weeks. Supplies from other countries were low (a total of 3 million m<sup>3</sup> of gas from Greece) and were

<sup>1</sup> Энергийна Стратегия на Република България до 2020 г., Държавен Вестник, Брой 43, 7 Юни 2011 г., page 13.

made after lengthy preparations. Although Bulgaria has connections with Romania, Greece, Turkey and Macedonia, which are part of the transit infrastructure used to transport Russian gas, it was unable to obtain gas in the necessary amounts. The Bulgarian government has definitely intensified efforts to improve the country's energy security since then.

Since the beginning of 2009, Bulgaria has entered into initial agreements for building gas interconnectors with Greece, Romania, Turkey and Serbia. The greatest progress has been made in the construction of the interconnector with Romania (Ruse–Giurgiu), which is to be put into operation by the end of 2012. Its flow capacity is to reach 0.5 billion m<sup>3</sup> annually and can be raised to 1.5 billion m<sup>3</sup>. In turn, the gas interconnector with Greece (Stara Zagora – Komotini), which is to be put into operation by the end of 2013, would give Bulgaria access to the planned Turkey – Greece – Italy (TGI) gas pipeline. The high flow capacity of the planned Bulgarian-Greek interconnector (3 billion m<sup>3</sup> with a possibility of being increased to 5 billion m<sup>3</sup> annually) indicates that it could be used in the future to transport Caspian gas through Bulgaria to South-Eastern and Central Europe. This idea fits in with the Southern Corridor concept, which is aimed at enabling Caspian gas supplies to Europe. At the same time, Sofia is making intensive efforts to obtain gas supplies from Azerbaijan. This concerns both representatives of the government led by Boyko Borisov and President Georgi Pырvanov, who is linked to the post-Communist team, both of whom are engaged in frequent contacts with representatives of Turkey and Azerbaijan. According to the Bulgarian energy minister, Traiko Traikov, Bulgaria will receive 1 billion m<sup>3</sup> of gas from Azerbaijan annually, starting in 2014. However, no binding contracts have been signed as yet.

Borisov's government is also pinning a lot of hope on the possibilities of producing domestic shale gas and is favourably disposed to foreign companies which specialise in the

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exploration of shale gas and testing production possibilities. Several exploration licences have been granted so far to three firms: Chevron (this firm estimates that the deposits in the Novi Pazar block may contain even 1 trillion m<sup>3</sup> of gas), Direct Petroleum Exploration (this firm announced in November 2010 that it had found deposits reaching 300 billion m<sup>3</sup>) from the US,

and the Canadian company, Park Place Energy. The government has also promised to hold more tenders for shale gas exploration. Shale gas production as an opportunity for improving energy security is envisaged in the governmental energy strategy. However, this has raised strong objections among the opposition, especially the post-Communist Bulgarian Socialist Party.

### The game for gas – the beginning of the end of the Russian monopoly?

Disputes between Sofia and Moscow in the area of gas concern both the conditions of the contracts which set gas supply rules, and the South Stream gas pipeline project. Bulgaria above all wants a lower gas purchase price and supplies directly from Gazprom. This lack of agents is expected to decrease the price and provide Bulgaria with an increased possibility to claim its rights should there be cuts in supplies<sup>2</sup>. In turn, Russia wants Bulgaria to keep its share in the SS project and is trying to obtain the best possible conditions for the implementation of this project, for example, demanding the inclusion of the Bulgarian transport infrastructure in the project.

<sup>2</sup> In response to Sofia's complaints about the overly high price of the gas supplied, representatives of Gazprom disclosed that the price in July 2010 was US\$ 339 for 1000 m<sup>3</sup>. They also admitted that the gas sale price to end users in Bulgaria was surprisingly high (it was then US\$ 576 for 1000 m<sup>3</sup>).

Bulgaria is trying to capitalise on its significance in the SS project to be offered the best possible gas supply conditions. This can be concluded from Sofia's delaying the establishment of a company for the implementation of the Bulgarian section of SS and also from the way gas negotiations were conducted in July 2010. On 17 July, Bulgargaz and Gazprom signed a letter of intent in Varna envisaging a reduction of the gas price in a future contract and the withdrawal of agent companies, and an intergovernmental agreement on a 'road map' for the implementation of the SS gas pipeline in Bulgaria was signed on the same day. This document provided for the quick establishment of a company in charge of building the Bulgarian section of the pipeline, which took place in November 2010. It also included a provision stating that transit of Russian gas *via* Bulgarian gas pipelines at the level of 17 billion m<sup>3</sup> annually would be retained. This was to dispel Sofia's fears that Russia will want to incorporate part of Bulgaria's transport networks into the SS project, thus reducing its costs. Russians would thus gain significant influence on the management of Bulgaria's transport infrastructure.

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The deadline for signing a new gas project as envisaged under the Varna deal expired in July 2011. It can be concluded from statements given by representatives of both firms that the parties have been unable to reach a compromise over a number of issues, such as gas price or quantity. The Bulgarian government has also withdrawn from its intention to sign a ten-year contract and has declared its readiness to sign a contract for a shorter term. The toughening of Bulgaria's stance and the overly long negotiation process are proba-

bly an effect of the ever closer perspective for the implementation of diversification projects, which is improving Bulgaria's negotiating position. However, it has to be emphasised that the scope and the intensity of Bulgaria's diversification efforts indicates that diversification is for Bulgaria a goal *per se*, and not only an element of pressure to obtain the best possible conditions of gas supply from Russia. However, while choosing diversification, Bulgaria is likely to pay very high prices of Russian gas in the transition period, i.e. while the interconnectors with its neighbours are being built (2012–2014).

### The game for the atom – a question of money

The dispute between Sofia and Moscow in the nuclear sector is focused on the issue of financing the Belene nuclear power plant. It is an effect of numerous irregularities which have taken place throughout the whole process of the management of the project. The investment commenced with no reliable economic analyses having been prepared; nor had financing sources been guaranteed or determined. An agreement with the strategic investor, which was supposed to find financing sources for the project, was signed almost a year after the binding power plant construction contract was concluded.

The Bulgarian National Electric Company (NEK) already in January 2008 concluded a contract for the construction of two WWER 1000 type reactors and construction work at the power plant with Russian Atomstroyexport (ASE), while the contract with the strategic investor, Germany's RWE, was signed as late as November 2008. It soon turned out that the contract with ASE was imprecisely defined and allowed Russian company to increase the construction costs significantly (it was not stated precisely, whether the contract value



is to be indexed according to the inflation rate in Russia or in Bulgaria). ASE insists that the price of the power plant will be a minimum of 6.3 billion euros, while NEK is ready to accept 5 billion euros. The companies have been unable to agree on the way of setting the final value of the contract for more than 3 years now.

RWE's withdrawal from the project has made the situation even more complicated. Sofia used this to freeze the investment and to re-launch the procedure evaluating the investment's cost-efficiency. Although the Bulgarian side agreed for Russia's Rosatom to replace RWE as the strategic investor (pursuant to the letter of intent of November 2010, it was to acquire 49% of the shares in the power plant at the most), but at the same time it turned down a 2 billion euro loan offered by the Russian side to finance the investment.

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The Bulgarian government has emphasised that a decision concerning the continuation of the investment will be taken when a new financial analysis of the project has been made and a Western source of financing is found. This met with a negative reaction from Russia, a sign of

which was a court suit brought by ASE against NEK in July 2011. The Russian company demanded 58 million euros as due payment for part of the work carried out by it. The suit was a sign that Moscow was ready to claim its rights in court, which was to convince Sofia to decide to continue the construction.

The disputes over the Belene nuclear power plant prove that Russia wants to implement this investment on the best possible financial conditions. The Russian side, threatening to launch damage-claiming procedures, is trying to force its Bulgarian partners to take a positive decision regarding this investment. Meanwhile, the Bulgarian stance on this issue is not obvious. For Bulgaria, this investment is important from the point of view of the realisation of its ambition to gain a strong position as an electricity exporter, which would provide a source of significant income and reinforce the country's position in the region. The activity of a strong Bulgarian nuclear industry lobby, which includes not only NEK but also numerous technological and consulting firms, should also not be disregarded. However, on the other hand, Sofia is delaying the completion of this investment in an attempt to negotiate the best possible financial conditions. It has also been facing such objective difficulties as the shortage of funds and doubts about the investment's cost-efficiency. The government led by Boyko Borisov has announced that the decision to either continue or discontinue the investment will be passed after the presidential and local elections in October 2011.

## Games in the oil sector

The disputes in the oil sector so far have mainly concerned the future of the Burgas–Alexandroupolis (BA) oil pipeline. Russia has been making attempts to force Bulgaria to make a positive decision concerning this investment, indicating that it can replace it with another project, the Samsun–Ceyhan pipeline running through Turkey. When Borisov and his team formed the government, Bulgaria withdrew political support from this investment. The main reason why the Bulgarian government disliked the project was to meet the expectations of Bulgarian public and tourist business halfway, who were very critical about this project. Sofia started delaying transfers of funds to the TransBalkan Pipeline<sup>3</sup>, the company in charge of implementation of this investment, and giving negative opinions on the environmental impact studies prepared by the company. This strategy brought the expected results. In September, Russia's Transneft announced it would be freezing this project, which can be understood as a form of tacit withdrawal from this investment.

<sup>3</sup> Shareholders of TransBalkan Pipeline: 51% – Russia's Transneft, Gazpromneft and Rosneft; 24.5% – Greece's Hellenic Petroleum and the Greek Treasury, 24.5% – Bulgaria's state-controlled Project Company Oil Pipeline Burgas–Alexandroupolis – BG.

A new reason for friction has emerged, namely the rule of operation of the Russian company LUKoil in Bulgaria. In July this year, the Bulgarian Customs Office cancelled the licence for oil import to the Neftechim Burgas refinery and the Rosenets oil terminal, both of which are controlled by LUKoil. The official reason was another delay in installing measurement devices necessary to precisely calculate the excise duty to be imposed, depending on the quantity of imported oil. Six days later, the administrative court in Sofia invalidated the Customs Agency's decision because it led to irreversible losses for LUKoil Bulgaria and posed a threat to the public interest (the Burgas refinery is the only supplier of aviation fuel in Bulgaria and implements a number of contracts signed with state-controlled companies). Despite the favourable court decision, the company is still facing a lot of problems. The Bulgarian competition protection office launched an investigation in August in connection with price conspiracy suspicions, where LUKoil is the main suspect.

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Sofia has entered into dispute with LUKoil in order to curb non-transparent practices on the fuel market. However, the actions taken give rise to a number of suspicions that the government might have been politically motivated while taking them. For example, it is unclear why the Customs Office applied this very strict sanction of licence cancellation instead of imposing a fine. The sudden launch of the investi-

gation against LUKoil by the Antitrust Office also seem dubious. The government and even LUKoil to a certain extent have benefited from the temporary confusion about the functioning of the refinery. The governing party, GERB, has reinforced its image as a grouping determined to enforce the law and struggling against the unpopular corporation (numerous protests due to high fuel prices have taken place in 2011). Prime Minister Borisov has also cut short any speculation about the powerful informal influence the head of LUKoil Bulgaria, Valentin Zlatev, reportedly has. This may be very important during the local and presidential elections this October. In turn, LUKoil has moved the dispute to court, thus gaining time to install the measurement devices.

## Possible scenarios

Russia and Bulgaria's energy co-operation covers projects of regional and European significance. Therefore, the prospects for the implementation of large energy projects do not depend solely on aspects of how Bulgarian-Russian relations develop. The impact of the global economic crisis, which will be adversely affecting the possibility of implementing common projects in the energy sector, should also be taken into account.

The experiences of the gas crisis and the process of liberalisation and integration of the gas markets within the EU have certainly provided a strong stimulus for redefining Bulgarian-Russian gas relations. New possibilities related to the production of shale gas are opening up in Bulgaria. The construction of a section of the Southern Corridor, which is to facilitate the transport of Caspian gas to South-Eastern and Central European countries, in Bulgarian territory is increasingly likely. Therefore, there is a real chance to reduce Bulgaria's very high dependence on Russian gas supplies. The need to ensure gas supplies before the new interconnectors are put into operation, which will take at least the next two years, is weakening Sofia's position while negotiating the new gas contracts. The dependence on Russian gas supplies may only be expected to be reduced in the medium term. Although it is difficult to say now what the future of South Stream will be, if a strong will for its implementation is de-

monstrated by the states and the companies participating in this project, Sofia will not block this investment.

A resolution of the dispute over the future of the Belene nuclear power plant, which may define the character of Russian-Bulgarian co-operation in this sector, seems to be much closer. The traditions of nuclear co-operation, the non-transparent decision-making process and the activity of strong nuclear lobbies in both countries may decide in advance that the investment will be implemented. Whatever the future of this project, Russia and Bulgaria are very likely to establish closer co-operation in the nuclear sector. The Bulgarian government is planning to extend the period of operation of the present nuclear power plant in Kozloduy, which was built with the use of Russian technologies.

No major change in the nature of co-operation in the fuel sector should be expected. Everything seems to indicate that the Burgas–Alexandroupolis oil pipeline will not be built, and Russia will remain the main supplier of fuel for Bulgaria. Although further frictions between the Bulgarian government and Russia’s LUKoil cannot be ruled out, the company will still be a powerful player on the Bulgarian fuel market.

## APPENDIX

### Energy balance of Bulgaria in 2009

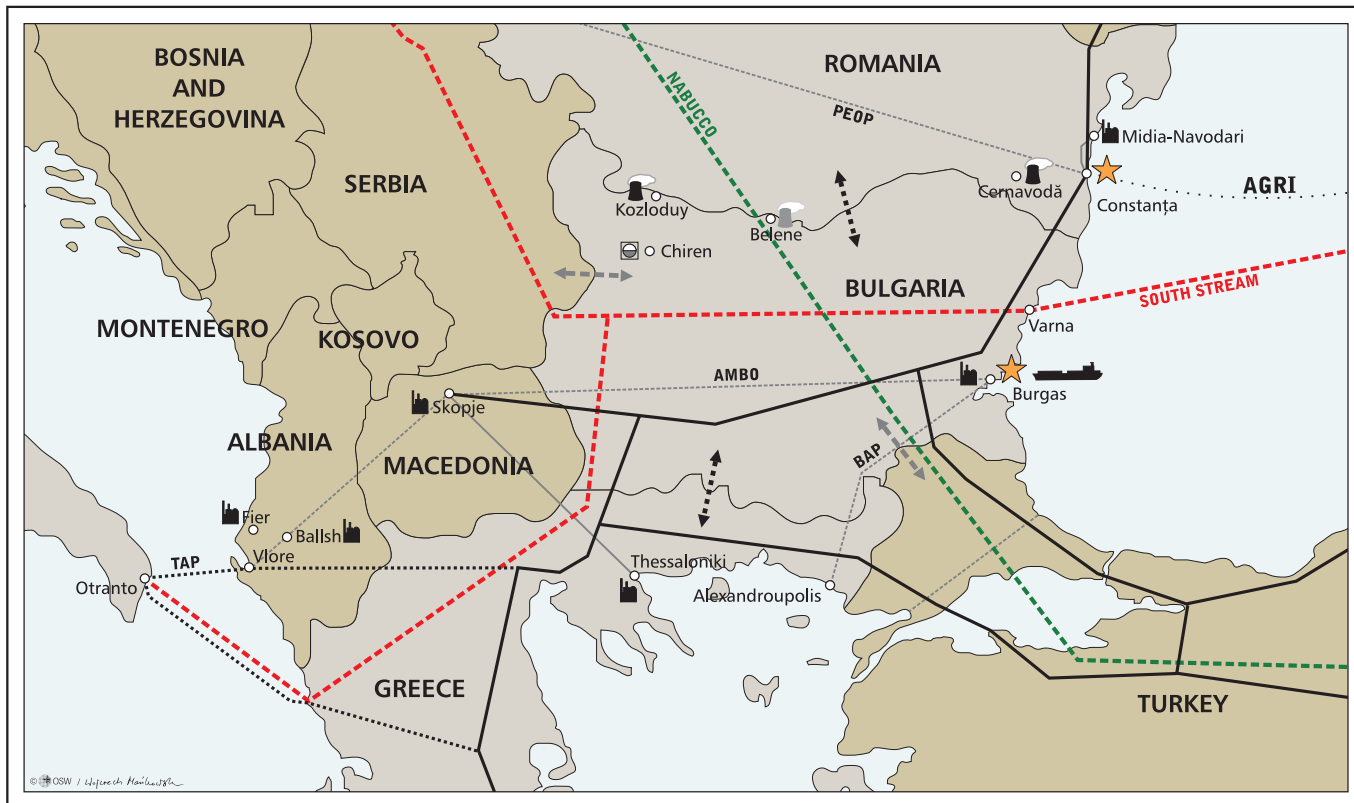
Data in thousands of tonnes of oil equivalent	Gross inland consumption	Primary production	Imports	Exports
Coal	6319	4560	1702	5
Gas	2162	13	2131	-
Oil and petroleum products	4364	25	7828	3166
Renewables and geothermal energy	794	752	-	-
Electricity from renewable sources (pumped-storage excluded)	318	318	-	32
Nuclear energy	3878	3878	-	-
Heat	42	42	-	-
Electricity	-436	-	229	665
<b>Total</b>	<b>17482</b>	<b>9588</b>	<b>11939</b>	<b>3868</b>

Source: National Statistical Institute (NSI)



## MAP

### Existing and planned energy infrastructure in Bulgaria



- |         |                                    |       |                              |       |                              |       |                       |
|---------|------------------------------------|-------|------------------------------|-------|------------------------------|-------|-----------------------|
| —————   | main gas pipelines                 | ..... | planned gas pipelines        | ..... | planned maritime connections | ————— | main oil pipelines    |
| .....   | planned gas pipelines              | ★     | planned LNG terminals        | ..... | planned oil pipelines        | ..... | planned oil pipelines |
| ←.....→ | interconnectors under construction | ☐     | gas storage facilities       | ..... | .....                        | ..... | oil terminals         |
| ←.....→ | planned interconnectors            | ☐ / ☐ | nuclear power plants/planned | ..... | .....                        | ..... | refineries            |

PEOP – Pan-European Oil Pipeline; AMBO – Trans-Balkan Oil Pipeline; BAP – Burgas-Alexandroupolis Oil Pipeline; TAP – Trans-Adriatic Gas Pipeline



**Centre for Eastern Studies**  
Koszykowa 6A,  
00-564 Warsaw  
e-mail: info@osw.waw.pl

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Editors: Olaf Osica  
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Translation: Ilona Duchnowicz  
Co-operation: Nicholas Furnival  
DTP: Wojciech Mańkowski