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## ANALYSES

## Russia's enormous budget deficit in 2009

On 30 January, the Russian government presented parliament with its summary of the financial situation and its economic forecasts to 2011. The government expects that the economic crisis will continue for three years, of which 2009 will be the most difficult for Russia in terms of economic results.

Russia's economic growth will come to a halt this year and a budget deficit of over 6% of GDP will occur. Due to the country's growing financial needs in times of crisis, even the very high currency reserves Russia holds may prove insufficient if no changes are made to the current economic policy, the implementation of which has so far relied mainly on budget funding.

### Projections for 2009

The government's projections from January, formulated on the assumption that the yearly average oil price will be US\$40, state that Russia's GDP growth in 2009 will be zero, inflation will increase to 13%, the average annual US dollar exchange rate will be 35.1 roubles, and that budget revenue will be lower than planned in the budget act by around 40%; in other words, it will decrease to 6.5 billion roubles (US\$180 billion at the current exchange rate of US\$1 = 36 roubles), leading to a budget deficit of 6.1% of GDP. Under the budget act, budget spending will amount to 9 billion roubles (US\$250 billion).

### The budget deficit and possible ways to cover it

Russia's economic problems stem from the government's negligence in diversifying the bases of Russia's economy. The country still depends on revenue from raw material exports, and is therefore susceptible to changes in the prices in international markets (especially in the case of oil). The price of oil has decreased from the peak level of around US\$150 per barrel in July 2008 to the current level of around US\$40, whereas the Russian 2009 budget bill has been formulated on the assumption that the yearly average oil price will be US\$95 per barrel. If the fiscal revenue decreases as expected, Russia will face a shortage of around US\$70 billion in covering the expenses already planned by the government, if no changes are made to the budget act. The deficit may be even higher in connection with the anti-crisis measures that the government plans to undertake this year, such as substantially supporting the budgets of the Russian Federation subjects, among other measures. The revenues of regional budgets will shrink by ano-

ther US\$30 billion, according to the Ministry of Finance, and part of this deficit will have to be covered by the federal budget.

The government now faces a dilemma concerning the sources of financing to cover the deficit. On the one hand, it could use the money from the reserve fund, which held US\$137 billion as of 1 January 2009, and the National Welfare Fund (US\$88 billion). These funds are deposited with the Central Bank and form part of Russia's currency and gold reserves (the total reserves were worth US\$386 billion as of 23 January). On the other hand, it may have to make cuts in budget spending. So far, it has been decided that the funding earmarked for investments would be reduced by 15%, or around US\$14 billion. The government has not been able to formulate its official position on the budget deficit as yet. It has been working on one for the last several weeks, although due to the dynamically changing indexes, the projections and scenarios for the development of the economic situation in Russia quickly become outdated.

For the last couple of weeks, the Russian authorities have been objecting to the possibility of cutting budget spending, especially on welfare and defence. They have been consistently promoting the view that possible shortages of fiscal funds may be fully covered from the reserves already held. However, the multi-billion-rouble anti-crisis programme which the authorities have been implementing since September last year, together with the Central Bank interventions in defence of the rouble exchange rate, have consumed more than US\$200 billion of the Central Bank reserves within the first four months of the crisis. The need for cuts in budget spending is therefore becoming increasingly evident.

## Conclusions

The projected huge budget deficit is a major challenge for the Russian authorities because there is no certainty that the financial reserves Russia has amassed over the last eight years will suffice to cover the budget deficit in the coming years of crisis. This means that the Russian authorities may not be able to continue financing their current economic policy, one of the main objectives of which has been to increase the level of state-ownership in the economy without paying heed to the actual effects of such measures. Facing public discontent, which is already becoming visible, the Russian authorities will prioritise welfare spending, and will therefore have to seek potential savings in other parts of the budget. Cuts in budget spending will be essentially impossible without harming the interests of the elite associated with the Kremlin, which has managed to take over control of a major portion of the Russian economy over the last eight years. The decisions that Vladimir Putin will have to take in the coming weeks may trigger conflicts within the Russian ruling elite.

*Iwona Wiśniewska*

## The Iskander missiles – Russia's apparent concessions

On 28 January, the Interfax agency quoted an unidentified representative of the Russian army's General Staff who claimed that work on the deployment of the Iskander operational-tactical missile launchers in the Kaliningrad oblast had been suspended. This was purported to be a gesture of good will towards the new US administration and a signal of Russia's readiness to start talks concerning international security policy. The news from Interfax appeared in the setting of a media campaign suggesting a covert agreement on international security issues might be concluded between the Russian authorities and the new US administration. The information about the possible deployment of Iskander missiles in the Kaliningrad oblast had been an element of Russia's propaganda intended to prop up the arguments of the European opponents of US plans to deploy the missile shield. In reality, Russia intends to continue the modernisation of its armed forces and to stick to the plan to deploy the Iskanders in the Kaliningrad oblast.

### Real arms...

Work on the new operational-tactical Iskander missile launchers was first started in the final days of the Soviet Union and, as was the case with the other newly constructed types of weapons, *de facto* stopped in the 1990s due to the disastrous condition of the Russian Federation's budget. The work was completed during the period of financial prosperity under Vladimir Putin's rule and the introduction of the Iskander missiles into the Russian armed forces' arsenal began. Since 2006, at least two missile squadrons of the 114<sup>th</sup> Znamensk Missile Brigade have been re-armed with the Iskanders. The *State Armaments Programme for 2007–2015* states that five missile brigades are to be equipped with the Iskanders, including the 152<sup>nd</sup> Missile Brigade stationed in Chernyakhovsk (Kaliningrad oblast), which is currently equipped with eighteen of the older-type Tochka-U/Tochka-M launchers. The re-arming of the 152<sup>nd</sup> Missile Brigade may be carried out sooner than that of the units stationed in the Asian part of the Russian Federation, for instance, especially given that the arms replacement in the Kaliningrad oblast has already started (in autumn 2008, the army started removing the T-72 tanks from there; they will probably be replaced as early as this year with the arrival of the first new T-90 tanks in Kaliningrad).

Re-arming the Russian army's missile brigades with the Iskander missile launchers will substantially increase their potential. Their basic weapon at the moment, the Tochka missiles, offer a range of 70 to 120 km depending on the version. The Iskanders have a longer range of 280 km in the basic (export) variant, and ultimately may offer a range of 500 km (the limit authorised under the 1987 INF Treaty on the elimination of intermediate and shorter-range missiles), if used

with the new R-500 cruise missiles. In addition, the Iskanders are much more technologically advanced than the Tochka – with their variable trajectory, they may potentially overcome tactical missile defence, such as the American Patriot systems.

### ... and the propaganda weapon

Russia first released the information about the possible deployment of the Iskander launchers in the Kaliningrad oblast in autumn 2006, linking the plans concerning the technical modernisation of the Russian army by 2015 and the USA's plans to deploy anti-missile launchers in Poland. The information activity concerning the deployment of the Iskanders was stepped up after the governments of Poland and the Czech Republic signed agreements providing for the deployment of a radar station and anti-missile launchers on their respective territories. The information that the Iskander launchers would be installed in the Kaliningrad oblast was also included in Russian president Dmitry Medvedev's address to the combined houses of parliament on 5 November 2008.

The purpose behind the Interfax report of 28 January that work has been suspended on deploying the Iskanders in the Kaliningrad oblast was to create the impression that Moscow would be inclined to stop strengthening its military potential, should Washington make changes to the US security policy (for example, by deciding not to install the missile defence system in Europe). However, it should be noted that what Russia offers is only an appearance of concessions, and the offer is largely for propaganda purposes.

### Conclusions

In line with the logic of the technical modernisation processes which of necessity take place in any modern army, the Iskander missiles will be deployed in the Kaliningrad oblast within the next few years, irrespective of the context in which they are being used at a given moment by Russian propaganda. This is part of the natural process of modernisation occurring in the armed forces, just as it is in any other sector. Most probably, the 152<sup>nd</sup> Missile Brigade in Chernyakovsk will be equipped with the Iskander launchers as originally planned, that is, by 2015 at the latest. The only modification possible could be a faster completion of the process, should Russia's relations with the United States continue to deteriorate.

The periodically repeated threats to deploy the Iskander missiles in the Kaliningrad oblast should be treated as an element of Russia's diplomatic strategy, the main objective of which is to reinforce the doubts which some European states have concerning the sense of continuing to support the US international security policy in its current form.

*Andrzej Wilk, Piotr Żochowski*

## EVENTS

## Russia and Belarus formalise the Joint Air Defence System

**On 3 February, during a meeting of the Supreme Council of the Union State of Russia and Belarus in Moscow, the two countries' presidents Dmitry Medvedev and Alyaksandar Lukashenka signed an agreement establishing the Joint Regional Air Defence System. The fact that Minsk has finally approved the document, which the parties had been negotiating for many years, means that Russia is starting to derive concrete benefits from subsidising and making loans to the Belarusian economy, which has been increasingly affected by the economic crisis.**

The joint Russian-Belarusian air defence system had in fact already been operational, although not on any formal basis. The creation of the Joint Air Defence System, the formation of a single air force command, had been the subject of negotiations since the late 1990s, and had been Moscow's most important objective in its military co-operation with Belarus. Minsk has repeatedly delayed the signature of the agreement as a way of deriving additional benefits, mainly with regard to economic issues, such as maintaining the benefits from low prices for energy resources. On 2 February, the Belarusian side announced that an annex to the 2009 gas supplies contract had been signed in late January, which set the yearly average gas price at US\$148 per 1000 m<sup>3</sup>. This is a preferential price that is acceptable for the Belarusian economy. Belarus has also been promised another loan from Russia for the amount of several tens of billions of roubles.

The signature of the agreement seems to be a success for Moscow, which has finally managed to persuade Minsk to make concessions, after a lengthy period of negotiations. The details of the document have not been disclosed, but it will presumably lead to a formal and permanent integration of the two countries' air defence systems. Thus Russia will gain more influence on the Belarusian armed forces. <WojK>

## Ukraine loses the dispute over Snake Island to Romania

**On 3 February, the UN International Court of Justice ruled that Snake Island was not part of the shoreline and therefore, in the dispute between Ukraine and Romania concerning the maritime border delimitation and the division of the shelf, it could not be considered as the outermost point of Ukrainian territory. The verdict is favourable for Romania, because as a consequence it will be accorded 80% of the disputed area, which holds a major portion (around 70%) of the shelf's substantial oil and gas reserves.**

Dating back to the collapse of the USSR, the dispute between Romania and Ukraine over Snake Island on the Black Sea concerned its status, namely whether it was an island, as claimed by the Ukrainians, or a rock, as in

the opinion of the Romanians. Resolving this issue was of key importance for delimiting the line separating the two countries' exclusive economic zones on the continental shelf, which is estimated to hold up to 100 m<sup>3</sup> billion of gas and up to 10 million tons of oil. Hosting a Ukrainian border post and a population of around one hundred, the island itself remains under the jurisdiction of Ukraine.

The Court's verdict, under which Snake Island cannot be regarded as part of Ukraine's territory, means that it cannot be taken into account in the delimitation of exclusive economic zones. This interpretation is more favourable for Romania. However, oil and gas extraction will require co-operation between both parties. Major global energy companies including BP have already expressed interest in developing the deposits. <abalc, AnG>

## Ukraine: Arseniy Yatsenyuk does not rule out running for president

**Arseniy Yatsenyuk, the former speaker of parliament, announced on 2 February that in May he would decide whether or not to run in the presidential election. In mid-March, the party he is creating will participate in early elections to the Ternopil district council. As his popularity rises, Yatsenyuk, whose polls showings today are not much worse than Yulia Tymoshenko's, may be regarded as a serious presidential pretender who may succeed in taking over large sections of Viktor Yushchenko and Yulia Tymoshenko's disillusioned electorate.**

Arseniy Yatsenyuk will turn 35 in May, reaching the age at which he will be eligible to run for the highest state office. In the course of his career, he has served as the economy minister of the Autonomous Republic of Crimea, first deputy president of the National Bank of Ukraine (in 2004 he was *de facto* manager of the Bank), economy minister and foreign minister of Ukraine, and finally, parliamentary speaker (until November 2008). He was originally elected to the parliament from the Our Ukraine list, and in the autumn of 2008 started creating his own party, called Front for Change.

In a poll carried out in late December 2008, Yatsenyuk was backed by 7.9% of the respondents, compared to 13.9% for Yulia Tymoshenko. A year before the election, this is a small margin, especially given the fact that Yatsenyuk cannot be held responsible for the economic crisis which will have a negative impact on Tymoshenko's popularity. Fearing a possible rival, Tymoshenko has started a campaign to discredit Yatsenyuk.

It seems that Yatsenyuk has not yet decided whether to run in the election. If he chooses to do so, he will be a major candidate because the voters increasingly need 'new faces'. Moreover, his candidacy is acceptable to most groups opposing Yulia Tymoshenko, including the oligarchs of the Party of Regions (as a modern technocrat and a candidate who will not polarise the electorate into 'western' and 'eastern' divisions). Yatsenyuk's candidacy is also uncontroversial for the West and for Moscow. <TAO>

## Georgia unilaterally limits military presence in the proximity of the conflict regions

**On 26 January, the Georgian defence minister Davit Sikharulidze and the head of the EU observer mission in Georgia (EUMM) Hansjörg Haber signed a memorandum under which Tbilisi will unilaterally limit its military presence in the areas adjacent to Abkhazia and South Ossetia and authorise EUMM observers to inspect its military facilities. The objective behind this concession by Tbilisi is to improve Georgia's image in the West as much as possible.**

Under the memorandum, Georgia undertakes not to deploy more than one battalion within 15 km of the borders of the separatist regions of Abkhazia and South Ossetia (in the case of South Ossetia, the zone width ranges between 15 and less than 10 kilometres); in addition, the document specifies the number and calibre of arms that may be deployed in the areas in question (*de facto* prohibiting the deployment of artillery and tanks, and only authorising defensive weapons). Moreover, Tbilisi has authorised EUMM observers to inspect all of its military facilities (on the condition that an appropriate note is sent 24 hours in advance). Haber has thanked the Georgian side for this 'courageous unilateral move', and said that the Russian side would now be pressured to respond with a similar concession.

The memorandum is very important for three reasons: firstly, it will improve the image of Tbilisi in the EU as the party which has been co-operating actively with the West to lower the tension around the conflicts (this reason seems most important for Tbilisi); secondly, implementation of the memorandum's provisions should lead to a genuine alleviation of tension in the volatile border area, and deprive the Russian side of the possibility to regularly accuse Tbilisi of infringing the ceasefire agreement; finally, it is tangible proof that the EU mission is operating effectively, which could not be said about the activities pursued in the region for the last several years by, for example, the OSCE. <bart>

## Kyrgyzstan wants Americans out of Manas

**On 3 February, the president of Kyrgyzstan Kurmanbek Bakiyev announced that his government had decided to close down the US military base in the Manas airfield near Bishkek. There is no doubt that Kyrgyzstan was forced by Moscow to take this decision. The financial assistance which Russia has decided to offer Kyrgyzstan should therefore be treated as 'pay' that Bishkek has received for taking a decision favourable to Russia. At the same time, Russia has clearly demonstrated that it considers itself to have a monopoly on security issues in Central Asia, and that Moscow is the only partner for any talks on this subject.**

President Bakiyev announced the closure of the base during his visit to Russia, immediately after a meeting with the Russian president Dmitry Medvedev. He quoted financial misunderstandings with the Americans and the Kyrgyz public's discontent with the presence of foreign soldiers as the reasons.

On the same occasion, Presidents Bakiyev and Medvedev signed an agreement under which Russia will provide Kyrgyzstan with a state loan of US\$2 billion (the grant of this loan had already been announced on 12 December by Prime Minister Vladimir Putin). Another agreement states that US\$ 1.7 billion of the loan will be used to jointly build the Kambar Ata hydro power plant on the Naryn river. In addition, Russia will also provide Kyrgyzstan with a non-refundable grant of US\$150 million, and offer another loan of US\$ 300 million on very favourable terms.

Russia has been seeking to eliminate the US military presence in Central Asia and strengthen its influence in the region. From this point of view, the final closure of the Manas airfield base would be a success for Russia. According to Washington, the statement by President Bakiyev has not finally resolved the case. Pentagon spokesman Geoff Morrell has said he hopes that the USA will be able to continue using the Manas base as support for the operation in Afghanistan. The Manas base issue is yet to be discussed by the Kyrgyz parliament, which must formally terminate the 2001 agreement between Kyrgyzstan and the USA (following which the base should be closed down within 180 days). <GÓR>

## CES

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