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ANALYSES

Russian fuel companies establish a foothold in Hungary

The Russian oil company Surgutneftegaz's purchase of 21.2% percent of shares in Hungary's MOL may have a significant impact on the Central European fuel market. This is the first time that the Russians have made such a serious investment in the region, and the acquisition is in line with earlier declarations concerning Russian plans for expansion in the area. The involvement of Surgutneftegaz, whose long-term objective seems to be to take control over MOL, may mean that a new player is emerging, with a strong raw-materials base and ample financial resources, and which will be capable of expanding further to eventually dominate the Central European market.

MOL: avoiding one merger to face another

On 30 March, Austria's OMV announced that it had sold 21.2% percent of its shares in MOL to Russia's Surgutneftegaz for €1.4 billion. This marked the end of OMV's attempts to merge with MOL, first initiated in the summer of 2007. OMV cited a lack of agreement with the prospective partner and the European Commission's negative opinion on the projected merger as its reasons. By taking over more than a fifth of MOL's shares, Surgutneftegaz, which is believed to be closely affiliated with Vladimir Putin, has become the Hungarian company's largest shareholder. This coincides with speculation that Russian capital may have already been involved in MOL for several years, although the size of this involvement cannot be exactly established because the shares have been dispersed (nearly 30% of shares in MOL are held by small shareholders).

The Russian firm will probably seek to gain wider influence on the Hungarian company, which is currently considered the weakest of Central Europe's three dominant fuel companies (the remaining two are OMV and Poland's PKN Orlen). The amount of the transaction testifies to the determination of Surgutneftegaz and the clarity of its objectives – the price paid for the stake is twice the current exchange market value of the shares acquired. However, in order to carry out their plans, the Russians will have to reach agreement with the MOL management, which indirectly controls nearly 49 percent of shares in the company (through various share-parking mechanisms). This situation has enabled the company's management to block any hostile actions, such as modifying the statutes or replacing the managers. The arrangements have been effective in blocking OMV's moves. However, in the case of Surgutneftegaz, MOL's management is in a weaker position because Russia is the key provider of oil for the company's refineries (LUKoil in Hungary and Gazpromneft in Slovakia). Furthermore, MOL has extraction assets located in Russia which, in the case of a confrontation, may be used by the Russians as a bargaining card in their dealings with the Hungarian company. Therefore,

APPENDIX

MOL shareholding

Entities loyal to the MOL management (jointly holding 48.9 percent of shares):

- OTP – 9.9%
- BNP Paribas – 7.4%
- CEZ – 7.3%
- Oman Oil Company – 7.0%
- Magnolia Finance – 5.7%
- ING – 5.0%
- MOL, proprietary shares – 4.8%
- MOL employees – 0.9%
- Hungarian Development Bank (MFB) – 0.9%

Other shareholders:

- Surgutneftegaz – 21.2%
- Public trading – 29.9%

it seems that it will only be a matter of time before strategic co-operation between MOL and the Russian investor begins, and that this co-operation will become a foothold for Surgutneftegaz's further expansion in the region. Such an expansion appears even more likely in the light of the MOL management's suggestions (which they first made in 2007) that the Hungarian company was willing to start co-operation with one of the Russian concerns.

Russia to expand into Central Europe?

The acquisition of a stake in a strategically important Central European company by a Russian oil concern is a continuation of Russian capital's expansion strategy in the region, which had already started several years ago. The only surprising element is that it involves the most secretive and non-transparent oil company in the Russian Federation. Surgutneftegaz's opaque and complex shareholding structure has given rise to speculation that the company may be owned by Vladimir Putin and people from his inner circle. Surgutneftegaz, a private oil company ranking fourth among Russia's top oil producers (with more than 60 million tons in 2008), has so far been the only Russian oil concern that did not invest abroad and had no assets outside Russia, although at the same time it managed to raise substantial funds estimated at over US\$20 billion.

According to unconfirmed information, the transaction with MOL was concluded at the Kremlin's request. For Surgutneftegaz, which is experiencing a deficit in processing capacity, the acquisition of a stake in the Hungarian company offered the obvious benefit of access to MOL's processing assets in the Central European market. The acquisition may also mark the start of Surgutneftegaz's foreign expansion. The Kremlin, which initiated the company's debut as a foreign investor, is probably also hoping to gain some political dividend, such as the Russian company's real involvement in the governance of Hungary's strategically important energy sector.

Consequences

Surgutneftegaz's takeover of shares in MOL marks another stage in the development of the Central European fuel market, and may alter the balance of powers in this sector. The process of consolidation involving the smaller regional fuel companies, dominated by Austria's OMV, Hungary's MOL and Poland's PKN Orlen, is now over.

The emergence of a new player with (by Central European standards) a strong position, may have significant long-term consequences. Direct access to the raw-materials base and financial resources, combined with MOL's production assets, could give it a major competitive edge in the longer term. Its activities would certainly extend beyond MOL's traditional markets of Hungary and Slovakia, and through gradual expansion, the company might gain an advantage over other market players, or even absorb or eliminate them.

Mariusz Bocian, Ewa Paszyc

Azerbaijan's gas export policy

In a memorandum signed on 27 March, Russia's state-owned Gazprom and Azerbaijan's SOCAR announced that they would enter talks concerning the sale of Azeri gas to Russia. The signature of the document became possible when Azerbaijan's international position faltered as a consequence of Russia's newly rebuilt influence in the Southern Caucasus following the Russian-Georgian war, combined with the fact that the prospects for implementing projects to export Azeri gas to the European Union remain distant. The memorandum does not guarantee that the supplies of Azeri gas to Russia will be launched, although it is an important signal meaning that Baku no longer views the Western direction as the only option for the export of its gas. Baku's intention is that this gesture should prompt the EU to take more concrete measures towards building a gas infrastructure to connect Azerbaijan with the EU.

The content of the memorandum

The memorandum signed by Gazprom and SOCAR on 27 March states that the parties will start formal talks concerning the terms and conditions of the sale of Azeri gas to Russia as of January 2010 (Gazprom's first proposal concerning such sales was presented in June 2008). Gas would be delivered to the Russian-Azeri border via the existing gas pipeline from Baku to Novo-Filya, which was used until January 2007 to transport imported Russian gas. The document also states that the parties will consider the feasibility of swap operations – in this variant, Russia would most probably supply oil to the Petkim petrochemical plant in Turkey, in which SOCAR holds shares, in exchange for the gas supplied by Azerbaijan. The memorandum does not mention the price or the volume of supplies, but it follows from earlier information that the gas price formula would be based on the average European price, and the volume of supplies would be around 1–2 billion m³ of gas a year. If confirmed, this information would mean that Russia's proposal is economically attractive for Baku.

The memorandum is primarily a formal invitation to negotiations concerning gas supplies to Russia, and does not necessarily mean that such supplies will actually be launched (Azerbaijan concluded similar memorandums with Greece and Bulgaria). Still, its signature is a success for the Kremlin's policy, because it demonstrates that supplies to Russia remain an important alternative to the European market for Baku.

Reasons for the memorandum's signature

The conclusion of the memorandum is a consequence of a number of factors which have undermined Baku's position. Firstly, the chances for the launch of the export of Azeri gas to Europe have diminished in recent months, the key reason being internal disputes within the European Union concerning the terms on which the Nabucco project (from Turkey via Bulgaria, Romania and Hungary to Austria) should be implemented; these disputes are best illustrated by the conflict concerning the award of funds for the project implementation by the European Commission. In addition, the prolonged dispute with Turkey

over the terms of transit of Azeri gas has so far effectively blocked plans to launch supplies to Greece and Bulgaria and, in the longer term, to Italy (via the existing Turkey-Greece connector pipeline and the projected Greece-Italy pipeline, as part of the so-called ITGI project).

Baku's position has also been undermined as a result of a number of geopolitical factors, including the fact that Russia is rebuilding its influence in the Southern Caucasus following the war in Georgia, and that the Kremlin has become actively involved in the process to resolve the Nagorno-Karabakh issue, which is a problem of strategic importance for Azerbaijan. Finally, economic factors have also played a significant role; Azerbaijan, which relied on oil for around 95 percent of its export revenue in 2008, has faced a deteriorating economic situation as oil prices have decreased, and has been forced to seek additional sources of income, for example from increased gas sales.

Azerbaijan's objectives

The unfavourable turn in external circumstances has forced Azerbaijan to try to play off the existing contradictions between the interests of the West (the EU and the USA) and the Russian Federation more actively. The purpose behind the signature of the memorandum is to strengthen Baku's bargaining position with the West by demonstrating that Western consumers face a real competitor, namely Gazprom. Thus, Baku hopes to obtain an attractive gas price and stimulate the interest of those countries interested in buying it. It also appears that the memorandum, which was signed immediately after the controversies surrounding the Nabucco project within the EU were revealed, was intended as a clear signal that this European project is not the obvious route for gas export from Azerbaijan.

It is difficult to predict the outcome of the rivalry over Azeri gas between the West and Russia, which Baku is heating up. It appears that despite the memorandum, the Western direction remains attractive for Baku, especially in geopolitical terms, but it is far from certain that Azerbaijan will actually choose it. If the West does not take rapid and specific measures to implement projects aimed at connecting Azerbaijan with the EU, the Russian alternative, which is concrete and potentially attractive for Baku in financial (though not necessarily geopolitical) terms, will gain importance for Azerbaijan.

Aleksandra Jarosiewicz

EVENTS

Russia reminds the world of its interests in the Arctic region

The full version of the document entitled "Assumptions of the Russian Federation's state policy in the Arctic region to 2020 and beyond", adopted in September 2008 by the Russian Security Council, was published on 27 March. It includes one element that had not been revealed before, a suggestion to create a special military formation for operations in the Arctic region. This means an escalation of the measures Russia is undertaking in response to the recent steps made by other actors interested in the Arctic.

In recent weeks, Moscow has repeatedly referred to the growing competition over the North Pole. The Russian Ministry for Foreign Affairs has made several statements criticising the (annual) NATO military exercise in the Arctic region of Norway, which were carried out in mid-March. Nikolai Patrushev, Secretary of the Russian Security Council, has accused the USA, Norway, Denmark and Canada of pursuing a co-ordinated policy designed to bar Russia from accessing the natural resources of the Arctic shelf, and the defence minister Anatoly Serdyukov criticised Canada's position on Russia's military flights over the Arctic region (Canada's PM and defence minister have stated that the flights were a provocation, and that Ottawa would not be 'intimidated' by Russia). With its current military capabilities, Russia could create the military formation in question without any major financial expenditure, for example, by reorganising the existing structure of command. However, neither the document nor the statements made by Russian officials offer an indication of what the specific nature of Russia's possible military presence in the Arctic region would be. This implies that the main objective behind the publication of the provisions of Russia's Arctic strategy has been to draw the media's attention to Moscow's readiness to actively defend its interests in the Arctic, and in particular, to gain control of the area's natural resources and ensure the possibility that the Arctic area could be used as a transport route. <MaK>

Attack on Sulim Yamadayev

Sulim Yamadayev, an opponent of the Chechen president Ramzan Kadyrov, was attacked in Dubai on 28 March. Yamadayev is in a coma; other sources suggest that he is in fact dead. The attack was probably inspired by certain groups opposed to Kadyrov within the Russian institutions of force. Their objective may have been to compromise the reputation of the Chechen leader, who has been gaining more and more independence from Moscow. However, it cannot be precluded that the attack was ordered by Kadyrov himself.

The Yamadayev family, which is very influential in eastern Chechnya, is opposed to Kadyrov but has remained loyal to Moscow. Sulim's brother, the former Russian Duma deputy Ruslan Yamadayev, was assassinated on 24 September 2008 in Moscow. Sulim used to command the "East" battalion of the GRU (military intelligence) *spetsnaz* until last year, and had been awarded the Hero of Russia title. The attack on Yamadayev was carried out on the eve of the projected formal ending of the Chechen war and 'anti-terror' operation, which have continued since 1999. This attack seems to run against Kadyrov's interests, as the

Chechen leader would like to be regarded as a responsible politician who is capable of governing the republic in the conditions of post-war stabilisation. It is also known that Kadyrov has been seeking loans and investments from Arab countries, and in this situation, ordering an assassination would compromise his reputation. It appears that the attack may have been ordered by persons or circles within the Russian secret services which are dissatisfied with Kadyrov's ongoing emancipation from Kremlin control. The Chechen leader has managed to neutralise the militants (most of them now serve under his command), exerts full political, security and economic control over the republic, and keeps demanding new powers, which has raised doubts about his loyalty. However, it is also possible that Kadyrov himself wanted to eliminate a potential rival in any future struggle for power (six Chechen activists opposed to Kadyrov have been assassinated in recent months in attacks carried out in the West, in Turkey, Russia, and Azerbaijan). <GÓR>

Date set for the presidential election in Ukraine

On 1 April, the Ukrainian parliament adopted a resolution by a massive majority setting the date of the presidential election for 25 October 2009. This election date favours the two main candidates, Yulia Tymoshenko and Viktor Yanukovich, because within the shorter pre-election period it will be more difficult to promote a third serious candidate.

All the parliamentary clubs (401 deputies) unanimously supported the draft proposed by the Yulia Tymoshenko Bloc (BYuT), and only a group of Our Ukraine deputies associated with the head of the President's Secretariat Viktor Baloha was against. According to unconfirmed reports, the unexpected inclusion of the draft in the parliament's agenda was related to rumours that the president intended to dissolve it within days.

When setting the earliest possible election date, the parliament relied on a disputable interpretation of the constitution, and it is possible that Viktor Yushchenko, who may not veto parliamentary bills, will lodge a complaint against it with the Constitutional Court.

The fact the election is to be held as early as October makes the task of conducting an election campaign much more difficult for Arseniy Yatsenyuk, the potential third frontrunner, who does not have an organisational backup spanning the entire country. The early date also favours Yulia Tymoshenko, who will be able to conduct her campaign before the probable major economic slump expected in late autumn. At the same time, the confirmation of the election date means that the Party of Regions and the BYuT will give up their efforts to oust President Yushchenko before the normal end of his term, and, in all likelihood, that the Party of Regions will not push for early parliamentary elections. <TAO>

Election campaign starts in Kyrgyzstan

On 27 March, Kyrgyzstan's united opposition organisations held a demonstration intended as a show of the opposition's strength and its mobilisation potential before the early presidential election to be held on 23 July. However, the small number of demonstrators in fact exposed the opposition's weakness and showed that its activities are not popular. It appears that President Kurmanbek Bakiyev will face no major problems in continuing in power for another term.

The opposition claims that the demonstration brought together between two and three thousand people. According to the authorities, however, there were fewer than eight hundred demonstrators. The main objective of the protesters was to prevent President Bakiyev, who has already declared that he would run for re-election, from participating in the election. The rally may be regarded as the opening of the election campaign. Although the opposition parties have managed to unite (the United National Movement, grouping all the major opposition parties, was established in December), the low turnout at the demonstration reveals their weakness. The opposition has not yet developed a constructive political programme, and it is doubtful whether it will manage to propose a common candidate. Moreover, for the last several months the authorities have been exerting mounting pressure on opposition activists (arrests, intimidation, beatings of independent journalists, etc.), in order to force them to be less active in the political scene. The opposition would benefit from a later election date, because the social and economic situation in the country is very likely to deteriorate in connection with the global economic crisis, which may trigger a rise in social frustration and prepare the ground for anti-government demonstrations. Fearing this scenario, the parliament (controlled by Bakiyev) decided to set an earlier election date, which offers the president a good chance of being re-elected for another term. <mf>

Unprecedented strike in Tajikistan

On 27 March, around four hundred employees of the strategically important Sangtuda-1 hydroelectric power plant in Tajikistan went on a two-day warning strike, after their wages payments had been suspended for four months. This was the first strike in many years to take place in Tajikistan, and it demonstrates that the people are increasingly frustrated with the deteriorating social and economic situation in the country, which has been badly affected by the global crisis.

The power plant management announced that the wage payments have been suspended because the state-owned Barki Tojik holding's outstanding electricity dues amount to more than US\$10 million. Sangtuda-1 is one of Tajikistan's key hydroelectric power plants and one of its most important investment projects. Currently, three blocks of the plant are operational, and a fourth is under construction (Russia's RAO UES is the main investor). The fact that Barki Tojik has been unable to pay its dues proves that the Tajik state is experiencing serious financial problems, or perhaps that it has become insolvent. The strike, on the other hand, shows that the traditional social apathy of the Tajiks, which has made governance easier for the Tajik authorities, may be overcome if the economic situation deteriorates drastically. This may lead to serious social unrest in the country. The Tajik authorities' inability to repay the debt, and the temporary suspension of construction works on the power plant, will also adversely affect Tajikistan's relations with Russia, which owns 66 percent of shares in the undertaking. <mf>

CES

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