

# EASTWEEK

ANALYTICAL NEWSLETTER  
FOR EASTERN EUROPE, RUSSIA, CAUCASUS, CENTRAL ASIA

ISSUE 19(169)

20 MAY 2009

PUBLISHED BY

CENTRE FOR EASTERN STUDIES /

OŚRODEK STUDIÓW WSCHODNICH

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## ANALYSES

## South Stream – new deals, old doubts

On 15 May, the bosses of Gazprom and the energy companies of Serbia, Bulgaria, Greece and Italy signed a set of documents in Sochi concerning the implementation of the South Stream pipeline, thus demonstrating their commitment to the Russian-endorsed project. As in the case of the previous gestures of support for the South Stream expressed by the Southern European states, the significance of the agreements concluded is mainly political. They are part of the 'competition' for gas pipelines which is taking place in this part of Europe; they also demonstrate the bipolarity of the policies of some EU states, which have been taking part in both the Russian project and in the competing EU projects (Nabucco and ITGI). This exposes the lack of unanimity and coherence within the European Union, something which may impede the implementation of the Brussels-promoted Southern Corridor concept. Nevertheless, the agreements signed in Sochi will not significantly accelerate the implementation of the South Stream, and neither do they solve the main problems associated with the project. In particular, they fail to lay down in detail the projected pipeline's main parameters, such as its final routing (in particular, of the key submarine section), the total costs and the sources of financing.

The South Stream is intended to run from Russia via the Black Sea to Bulgaria and then separate into two branches, the northern one via Serbia to Slovenia and Austria, and the southern one to Greece and Italy. The deals signed in Sochi modify some of the project's parameters. The annex to the memorandum concluded between Italy's ENI and Gazprom states that the target capacity of the route should be increased from 31 billion to 63 billion m<sup>3</sup>. The agreements with Bulgaria's Bulgarian Energy Holding, Greece's DESFA and Serbia's Srbijagas lay down the rules according to which the companies that will build the land sections of the South Stream on the territories of Bulgaria, Greece and Serbia should be created and operate. The documents also state that a comprehensive feasibility study for the project should be performed by mid-2010, and the final investment decision should be taken by the end of 2011. According to Gazprom's current plans, the gas pipeline should be completed by the end of 2015, and its implementation should cost around €8.6 billion.

The agreements concluded are primarily another gesture of support for the project itself and for closer co-operation with Russia in the gas sector on behalf of the Southern European companies and the countries concerned. At the propaganda level, Russia mainly intends them to demonstrate that the project is well advanced, especially when compared to the European Union's key gas supplies diversification project, the Southern Corridor, and the Nabucco gas pipeline that forms part of it. The Sochi documents, which were signed one week after the EU energy summit devoted to the Southern Corridor by the Eu-

European companies participating in that project, were also intended to highlight the lack of unanimity within the European Union. While they do not preclude the participation of Bulgaria, Greece or Italy in alternative undertakings to the Russian project, they do show that the EU does not have a single view on how to diversify gas supplies or the priorities of its energy security policy. The plan to double the South Stream's capacity is intended on one hand as an argument to challenge the purposefulness of building alternative gas pipelines (including those comprised in the Southern Corridor), and on the other as a way to limit the importance of the existing routes for Russian gas exports, especially transit via Ukraine.

However, the Sochi deals do not make a great difference as far as the actual implementation of the South Stream is concerned. While the agreements concluded with the Serbian, Bulgarian and Greek companies lay down the terms on which the pipeline would be built on the territories of these states, the technical and financial details of the investments will be known only after the projected feasibility studies have been completed (by the end of 2009). Moreover, in order for the complete plans of the land part of the project to be finalised, similar agreements have to be signed with Slovenia (no agreement has yet been reached about the terms) and Austria, as well as an intergovernmental agreement with Italy. The details concerning the implementation of the key, submarine section of the South Stream have not been established either, and it is this part of the investment that may prove the most expensive and technologically complicated (as suggested by the experience with the Blue Stream, the gas pipeline from Russia to Turkey via the Black Sea). The routing of the submarine section and the process of obtaining permission for construction may also turn out to be procedurally complex and time-consuming (as the example of the Nord Stream indicates).

In the absence of a comprehensive feasibility study for the project, the projected gas pipeline's parameters given by the Russian side cannot be conclusively verified. Gazprom's estimates of the total investment cost are particularly dubious – according to Russian and Western experts, the South Stream may cost €20–25 billion instead of €8.6 billion, making it one of the most expensive gas pipeline projects in Europe. Meanwhile, there are no guaranteed sources of funding for the project, and the chances that funds will be raised in the immediate future are rather slim, due to the economic crisis and the financial difficulties being experienced by the energy companies concerned.

Despite Gazprom's commitment, it is not clear at this stage where the gas for the South Stream should come from – since there are few opportunities for domestic production in Russia to rise in the near future, filling the new route would most probably require large quantities of gas to be diverted from other export directions (which would necessitate modifications to the gas supplies contracts signed with individual European buyers), or additional quantities of gas to be procured from alternative sources (especially the Caspian region).

Finally, the issues concerning the management of the projected gas pipeline and the sale of gas from the South Stream in the European market have not been resolved yet. In particular, the Sochi agreements do not resolve the controversy between the main South Stream partners, ENI and Gazprom, which became apparent before the Sochi meeting. The absence of agreement over the Italian company's demands may impede the project's progress; ENI wishes to sell gas from the South Stream not only on its domestic market but also in other European countries, is seeking a higher share of revenues from gas sale than currently provided for, and wants to co-manage the land section of the pipeline.

The unclear points concerning the South Stream project's final form and how it will be implemented, the differences in the cost estimates and the controversies between the project partners indicate that the project is still at a relatively early stage, and that formalising the enterprise may run into difficulties. So it is difficult at this stage to assess the likelihood of its successful implementation. The main purpose behind publicising the information on the deals signed, including both the intergovernmental agreements and the contracts between companies, is to serve the provisional objectives of Russia, the most important of which seems to be to hinder the European Union's projects to diversify gas supplies to the Southern Europe and the Balkans.

*Agata Łoskot-Strachota, additional cooperation by Ewa Paszyc*

## EVENTS

**Russia sets up a commission to combat the 'misrepresentation of history'**

**On 15 May, President Dmitry Medvedev appointed a "commission to combat attempts to falsify history in a manner detrimental to Russia". The commission's composition and its stated objectives indicate that its work will focus on propaganda measures, rather than on developing research-based arguments to support the Russian interpretation of history.**

The commission's tasks have not been defined in detail; its mission is to monitor any instances of "falsification of historical facts intended to damage the Russian Federation's international prestige", and to develop strategies to prevent such acts. The commission will be run by the head of the Presidential Administration, Sergei Naryshkin. Of the total of 28 members, only two are historians; most of the other members are representatives of the administration (the Presidential Administration, the government itself) and the institutions of force (the Federal Security Service, the Foreign Intelligence Service, the General Staff, the Security Council) as well political scientists involved in political activity, whose views are based on the vision of Russia as a world power (Natalia Narochitskaya, Sergey Markov).

The composition and the mission statement of the commission indicate that it will be nothing more than a propaganda tool for the authorities, for use both in foreign policy and in internal affairs, and that it will rely on the ideology of the Soviet Union's victory over Nazism and its liberation of Europe. The Law currently in preparation on preventing the rehabilitation of Nazism in the former Soviet Republics, which uses a broad interpretation of the 'rehabilitation of Nazism' and is intended to combat "desecration of the memory of the victims of the Great Fatherland War", may introduce specific legal instruments against the 'falsifiers of history'. If the law enters into force, Russia may be able to use economic or political sanctions against the Baltic States or Ukraine, or to hold the citizens of these countries criminally responsible. <JR>

**Russia reports a sharp fall in its GDP**

**On 15 May Rosstat, the Russian statistical office, announced that Russia's GDP had fallen by 9.5 percent in the first quarter of 2009 (compared to the same period in 2008). This very poor result demonstrates that contrary to the government's expectations, the crisis in Russia is worsening, and that Russia may report a declining GDP once more in 2010.**

The preliminary data published by Rosstat show that Russia's GDP fell sharply, especially when compared with the last quarter of 2008, i.e. by 23.2%. Rosstat did not specify which sectors of the economy were responsible for the slump (data for individual sectors are to be published in the second half of the year). The only figures available concern industrial production (down by 14.3% compared to the first quarter of 2008). They indicate that economic activity was lower in practically all sectors of the economy, of which the most

affected was the processing sector (down by 20.7%). Russia's poor economic results in the first quarter have been caused by sharply reduced investor and consumer demand, as well as lower exports.

The deep decline in economic activity has surprised the government and forced it to change its GDP forecasts for the entire 2009, especially since the figures on industrial production in April show that the downward trend is continuing. According to the current official estimates, Russia's GDP will decrease by 6–7.4% in 2009 (compared to the previous estimate of 2.2%). In 2010, a 2% decrease is expected; in the most optimistic scenario, the GDP will simply stagnate. <iwo>

### Russia: Gazprom experiences problems with gas sales in Europe

**On 15 May, the International Energy Agency (IEA) published its statistical data on gas demand in the European Union in the first quarter of 2009. Against this background, Gazprom's quarterly sales results, as published in late April and early May, appear very poor. The main reason for this is the monopoly's insufficiently flexible price policy, as a result of which Russian gas is currently the most expensive in Europe. But although Gazprom's position has been undermined by the current crisis, the Russian monopoly remains the largest gas supplier to the EU.**

According to the IEA, gas consumption in the European Union decreased by 2–3% in the first quarter, and gas imports dropped by around 12% compared to the first quarter of 2008. In the same period, Gazprom's supplies to Europe fell by 39% (by 50% in the case of Germany and Italy), and its share in gas imports to the European market (including Turkey) shrank from around 30% to 18% (although Gazprom remains the number one supplier). One of the reasons why Gazprom's sales have declined so deeply is the high price at which the company sells gas in Europe (currently, US\$390-400 per 1000 m<sup>3</sup>). According to the Russian daily *Vedomosti*, NorskHydro sells gas at US\$360-370 and Shell at US\$333. Both companies have adjusted their prices as demand decreased, and their sales either grew (by 5% in the case of StatoilHydro), or remained unchanged (Shell). The factors that contributed to the deep decline in Gazprom's sales in the first quarter included the two-week interruption in gas supplies caused by the Russian-Ukrainian conflict in January, and the buyers' ability to temporarily reduce the volume of gas collected, even under the 'take or pay' contracts. The cheapest gas in Europe is supplied by BP at US\$196.40 (the British company mainly operates spot supplies, in which case the price is more flexible than in long-term contracts). In these circumstances, Gazprom's buyers have been limiting their gas purchases in anticipation of a deeper price reduction in the second half of the year (gas prices change alongside the prices of oil, with a delay of 6 to 9 months). Despite its problems with sales, Gazprom has no plans to change the manner in which it operates in Europe. <epa>

## The head of the Ukrainian President's Secretariat resigns

On 18 May, President Viktor Yushchenko dismissed Viktor Baloha as head of the President's Secretariat, at Baloha's own request. According to Baloha, the immediate reason for his resignation came from his objection to the president's decision to run for re-election; there is no doubt that co-operating with the head of state, whose popularity has been eroding, is no longer in line with Baloha's political interests. While leaving the Secretariat, Baloha will retain some influence there (his aides keep their posts for the time being), but at the same time he is free to build up his own political backup and image.

The most recent polls have shown Baloha to be more popular than Yushchenko. In the past, Baloha had handed in his notice on several occasions; this time, however, he could not be persuaded to withdraw the request. Thus, the last influential politician with nationwide recognition has quit the president's circle. The new head of the Secretariat is Vira Ulyanchenko, Yushchenko's long-time aide who has no political ambitions of her own. Yushchenko has recently made her chair of the People's Union/Our Ukraine political council.

As a talented and ambitious politician, Baloha is not linking his political future to the upcoming presidential election. Having broken with the president, he will now develop his own party (United Centre) and prepare for the 2011 local elections and possible early parliamentary election. His objective is to build up a strong position in selected districts, especially in his home region of Transcarpathia. <TAO>

## Turkish PM eases Azerbaijan's fears

During his visit to Baku on 13 May, the Turkish prime minister Recep Tayyip Erdogan assured Azerbaijan that Ankara would not open Turkey's border with Armenia until clear progress is made in the peace negotiations concerning the ending of the Karabakh conflict. The visit has improved the atmosphere in relations between Turkey and Azerbaijan, which have recently been tense; however, Erdogan's statements have provoked negative reactions in Yerevan and Moscow.

The objective of Erdogan's visit was to repair Turkish-Azerbaijani relations, which were seriously damaged by the signature on 22 April of the Turkish-Armenian accord on normalising mutual relations, referred to as the 'road map'. Baku has been concerned that Turkey would open the border with Armenia irrespective of the status of the Karabakh negotiations. The fact that no agreement had been reached concerning the price of gas exported from Azerbaijan to Turkey had also been a source of tension (the current price is US\$120 per 1000 m<sup>3</sup>, and the Azeris are demanding a price increase). Erdogan's visit may be considered fruitful: the Turkish PM has approved the gas price increase (although no exact new price has been set), and the Azeri president Ilham Aliyev stated that Azerbaijan was satisfied with Ankara's position on Karabakh. Erdogan's statements have come in for criticism from Armenian and Russian officials, who made it clear that Ankara should not interfere excessively with the negotiations concerning Karabakh. For the last several months, Moscow and Ankara have been promoting a process to re-

build the geopolitical situation in the Southern Caucasus which envisages the normalisation of relations between Turkey and Armenia, and the development of an initial agreement on Nagorno-Karabakh, among other moves. The visit and the Russian and Armenian reactions to it show that this objective will be difficult to achieve, not only because the interests of Baku and Yerevan are contradictory, but also because Moscow does not want Ankara to build up an excessively strong position in the region. <mf>

## Uzbekistan announces plans to launch gas exports to China

**On 13 May, Uzbekistan's oil and gas company Uzbekneftegaz officially announced that it would export gas to China via the Turkmenistan-Uzbekistan-Kazakhstan-China gas pipeline which is currently under construction and should be completed before the end of this year. The statement is the first clear manifestation of Tashkent's ambition to diversify its gas exports at the expense of Russia, which is currently the main buyer of Uzbek gas.**

Uzbekneftegaz has not revealed the quantity of gas it intends to export using the gas pipeline, stating that this issue is still the subject of negotiations. At the same time, the company's representative said that the gas would come primarily from fields operated by Chinese companies (China's CNPC is among the companies that are currently conducting exploratory work on fields in the Fergana Valley). Starting gas exports to China would allow Uzbekistan to diversify its exports, which until now have mainly been destined for Russia and, in smaller quantities, the neighbouring countries of Tajikistan and Kyrgyzstan. The declaration itself strengthens Tashkent's position towards Moscow, especially in the light of the fact that since April, when gas supplies from Turkmenistan were interrupted, Uzbekistan has been the largest supplier of gas to Russia. It is also possible that Tashkent has decided to reveal its plans to start gas exports to China in order to encourage Russia's Gazprom to maintain its current high price on Uzbek gas. Uzbekistan plans to raise the volume of gas supplies to Russia this year in order to benefit from the good price situation. <ola>

## CES

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