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OSW COMMENTARY

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Germany's gas policy – more than just Russia

Łukasz Antas
Co-operation: Agata Łoskot-Strachota

Cooperation with Russia in securing gas supplies is a priority for Germany, which is best demonstrated by the participation of German companies in the Nord Stream project. Another element of the policy of gas security, although one which has had less publicity, is the active search for sources of gas and supply routes alternative to Russian ones. Collaboration with other gas-producing countries has consistently been developed since the 1990s. After the gas conflicts among Russia, Belarus and Ukraine, German companies – with political and financial support from their government – have intensified their activities, in order to maintain a diversified structure of gas supplies. Moreover, the German government has consistently implemented a policy of encouraging the limitation of the growth rate of domestic gas consumption. It can be assumed that whereas Berlin sees its alliance with Russia as an important element of the policy of energy security, it does not want an excessive dependence on Russian gas supplies to occur. Germany has succeeded in combining its partnership with the Russian Federation (RF) with the diversification of its sources and routes of gas supplies, both through public support for closer energy cooperation with the RF and its parallel, unpublicised development of relations with other gas-producing countries.

The German gas sector – diversification, thanks to a consistent policy

The structure of gas supplies in Germany is now one of the most diversified in the European Union. This diversification has been consistently promoted since as early as the 1990s (see graph), when a considerable drop in supplies from the Netherlands and decreased domestic supplies were compensated for by the increased import from Norway. Despite the strengthening of political relations between Germany and Russia in the 1990s, this did not translate into a significant increase in dependence on Russian gas imports. In comparison with 1990, imports from Russia rose by about 16 bn m³ (+4%). Norwegian supplies were increased by 20 bn m³ in the corresponding period of time (+15%). In 1991, gas supplies from Russia covered 33.5% of gas consumption in Germany (gas supplies from Norway covered 12.7%), whereas in 2008 they covered 38% (with 28% of supplies coming from Norway; see graph).

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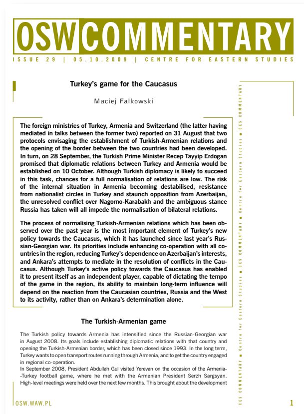

OSW COMMENTARY

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Turkey's game for the Caucasus

Maciej Falkowski

The foreign ministries of Turkey, Armenia and Switzerland (the latter having mediated in talks between the former two) reported on 31 August that two protocols envisaging the establishment of Turkish-Armenian relations and the opening of the border between the two countries had been developed. In turn, on 28 September, the Turkish Prime Minister Recep Tayyip Erdogan promised that diplomatic relations between Turkey and Armenia would be established on 10 October. Although Turkish diplomacy is likely to succeed in this task, chances for a full normalisation of relations are low. The risk of the internal situation in Armenia becoming destabilised, resistance from nationalist circles in Turkey and staunch opposition from Azerbaijan, the unresolved conflict over Nagorno-Karabakh and the ambiguous stance Russia has taken will all impede the normalisation of bilateral relations.

The process of normalising Turkish-Armenian relations which has been observed over the past year is the most important element of Turkey's new policy towards the Caucasus, which it has launched since last year's Russian-Georgian war. Its priorities include enhancing co-operation with all countries in the region, reducing Turkey's dependence on Azerbaijan's interests, and Ankara's attempts to mediate in the resolution of conflicts in the Caucasus. Although Turkey's active policy towards the Caucasus has enabled it to present itself as an independent player, capable of dictating the tempo of the game in the region, its ability to maintain long-term influence will depend on the reaction from the Caucasian countries, Russia and the West to its activity, rather than on Ankara's determination alone.

The Turkish-Armenian game

The Turkish policy towards Armenia has intensified since the Russian-Georgian war in August 2008. Its goals include establishing diplomatic relations with that country and opening the Turkish-Armenian border, which has been closed since 1993. In the long term, Turkey wants to open transport routes running through Armenia, and to get the country engaged in regional co-operation.
In September 2008, President Abdullah Gul visited Yerevan on the occasion of the Armenia-Turkey football game, where he met with the Armenian President Serzh Sargsyan. High-level meetings were held over the next few months. This brought about the development

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ANALYSES

Putin's visit to China focuses on raw material co-operation

On 12–15 October, the Russian prime minister Vladimir Putin paid an official visit to China. The visit was mainly devoted to issues of economic co-operation. A number of economic agreements were signed, including a preliminary agreement on terms and conditions for gas supplies from Russia to China. However, the parties still have not reached agreement on the price of the gas, which remains a major point of contention. On the eve of the visit, the Russian media informed that in September, Russia and China had already agreed on an extensive programme for Russian-Chinese regional co-operation in East Siberia and the Far East, running until 2018.

Even if many of the documents signed are just declarations and plans, the visit has revealed that Russia and China have different visions of how their bilateral relations will develop in the future. Russia's strategy is to drag China into a system of economic interdependencies: in return for assistance in developing East Siberia and the Far East on Russia's terms, China is supposed to receive supplies of raw materials and participate in their distribution onto the Chinese market. Russia thus also intends to neutralise those of China's potential policies which could be detrimental to Russian interests, including uncontrolled economic and demographic expansion. At the same time, Moscow is aiming to present its relations with Beijing to the West as a strategic alliance, for purposes of propaganda. Beijing, however, views Russia only as the supplier of raw materials for its rapidly growing economy, and not as a true political ally.

The current preliminary gas deal and the regional co-operation programme as well as the previous agreement on oil supplies and the US$25 billion loan from China to Russian energy companies which was signed this February all indicate that the model of Russian-Chinese relations is evolving rapidly, and that China is gaining the upper hand. A Chinese presence seems necessary for Moscow to help it develop the eastern regions; however, China's economy does also have alternatives to supplies of East Siberian natural resources in the foreseeable future. It therefore seems that the model of co-operation will be defined mainly by the Chinese side; this may mean that Russia will be reduced to the role of a supplier of mineral resources.

Towards a gas contract

The most important outcome of the visit consists in the signature of a preliminary agreement between Gazprom and China's energy company CNPC laying down terms for gas supplies from Russia. The document is a more detailed variant of the agreement concluded in February 2006, and provides for the gas to be supplied via two routes, from fields in West Siberia (around 30 billion m^3 a year) and from fields in East Siberia and the Far East (around 38 billion m^3). According to Gazprom, supplies could begin as early as 2014–2015, but

APPENDIX

1. Gas fields in East Siberia and the Far East

The gas reserves of East Siberia and the Far East are not currently being exploited, except for Sakhalin-2 where extraction started only this year, and Yakutia (Sakha) where small quantities of gas are being extracted for local consumption. In order to develop the region's gas fields, in 2007 Gazprom launched the so-called 'eastern programme' which provides for the creation of extraction centres in the Krasnoyarsk krai, the Irkutsk oblast, Yakutia and Kamchatka, and the construction of the necessary transmission infrastructure. Implementing the programme requires massive investments (also because installations must be built to purify the natural gas of helium, as the two are mixed in the East Siberian deposits). However, Gazprom is not in a position to make the necessary investments on its own.

Gas for the projected gas pipeline from East Siberia to China (to be built along the East Siberia-Pacific Ocean VSTO oil pipeline) is to come from the largest two fields of the region: Chayandinskoye (with reserves of 1.2 billion m^3) owned by Gazprom, and Kovykta (with reserves of 2 billion m^3) controlled by TNK-BP (which nevertheless may shortly lose its licence in favour of Gazprom). According to the plans, the operation of Chayandinskoye could start in around 2016.

Until now, Chinese companies had no shares in gas fields in Russia. However, shortly before Vladimir Putin's visit to China, the Russian media announced that a previously unknown Russian-Chinese Investment Energy Company (controlled by the Hong Kong-based RusEnergy Investment Group) had acquired 51% of shares in Suntarneftegaz, the holder of a licence for the East Siberian fields of Yuzhno-Berezovskoye and Cherendeiskoye with reserves of up to 60 billion m^3. The Suntarneftegaz board of directors is headed by Viktor Khmarin, Vladimir Putin's colleague from their past as students.

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this seems unlikely as the parties have yet to agree on the main issue which has impeded the signature of the final contract for years, namely the price of the gas. Moscow wants to have the contract signed because this would further the development of the East Siberian fields (see Appendix 1), which are of key importance for the development of the Russian energy sector; however, it wants to sell gas at European prices. The Chinese expect a much lower price, and while Beijing is interested in importing gas from Russia, such imports will not be essential for the next several years because China has ensured gas supplies from Central Asia and other sources. This strengthens China's bargaining position, and so the signature of a contract with a price formula to June 2010 (which is what Gazprom claims will happen) is in fact unlikely unless Russia makes concessions.

It also appears that the Chinese are mainly interested in gas supplies from Sakhalin and East Siberia to the eastern part of China, and in gas supplies from West Siberia to western China (which is the destination for gas from Central Asia) to a lesser degree. Gazprom, on the other hand, is prepared to launch supplies from West Siberia first. Moreover, arrangements are in place under which gas from Sakhalin-2 will be purchased for over twenty years by Japanese and Korean companies (meaning any potential deliveries to China require the development of the new fields). Developing the fields in East Siberia will require enormous investments to be made and costly gas pipelines to be built. The Chinese could possibly finance the infrastructure development to a large extent, although they would probably expect co-ownership of the fields in return, which Russia has objected to until now.

The fact that the preliminary gas deal has been signed even though no price formula has been stipulated indicates that Russia is trying to use its future gas co-operation with China for propaganda purposes as part of its European policy. On the one hand, Moscow is trying to obtain more support from the EU member states for the gas pipeline projects (Nord Stream and South Stream), keep in place its long-term contracts for gas supplies to the EU countries, and attract more investment in the development of the large energy reserves in the Arctic region (such as the Yamal). On the other hand, Russia intends in the medium term to diversify its energy resource exports for which Europe is currently the main market.

Other arrangements

During the economic forum organised on the occasion of the visit, the parties signed deals worth over US$3.5 billion, as well as a US$1 billion contract for the construction of a 'super dockyard' in Vladivostok to build drilling rigs, an agreement on the participation of Russia's Atomstroiexport in the extension of the Tian-Wan nuclear power plant, and a memorandum between the Russian and Chinese railway companies concerning the construction of a high-speed railway in Russia. Rosneft and CNPC signed the long-negotiated agreement on joint construction and operation of an oil refinery in Tianjin (worth US$3 billion, with a capacity of 10 million tons a year) and 300 filling stations. In this way, the Russian energy company (which will control 49% of shares in the enterprise) has managed to enter China's internal market for the first time. The example of Rosneft is a good illustration of the efforts big Russian companies have made to establish a presence in China.

2. *Programme for co-operation between the Russian regions of the Far East and East Siberia and the North-Eastern region of China in 2009–2018*

This twenty-page document lists 205 Chinese-Russian projects to be implemented to 2018 in Russia and in China. Sample projects to be carried out on Russian territory include the development of coal, molybdenum, gold and copper fields in the Zabaykalsky krai, the construction of a timber processing plant in Chita, the development of the magnesium, silver and apatite deposits in the Irkutsk oblast, the development of coal fields in Magadan and Kamchatka, the construction of the Verkhneye-Telekayskoye–Anadyr oil pipeline (138 km), and the construction of a heat & power plant and a sugar plant in the Amur oblast. The document also mentions the modernisation of existing border crossings and the creation of new ones, co-operation in the field of transport, the creation of a number of joint technology parks in Russia and in China, as well as tourism and environmental co-operation.

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Regional co-operation

On the first day of Putin's visit, the Russian daily *Vedomosti* published the text of the *Programme for co-operation between the Russian regions of the Far East and East Siberia and the North-Eastern region of China in 2009–2018,* approved on 23 September by Presidents Dmitry Medvedev and Hu Jintao during their meeting at the UN session in New York. This extensive document lists 205 planned joint projects, most of which concern the extraction of resources in Russia (including coal, iron ore and noble metals) and the processing of timber (see Appendix 2 for details). The projects are supposed to be implemented using Chinese technology, investments and labour, and the processing of raw materials is to take place in China. If the document is implemented, it will mark a turning point for the Chinese economic presence in the Russian East Siberia and the Far East. The document also demonstrates that Russia views China as a key partner for the economic development of the region.

Wojciech Konończuk

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The ongoing degradation of the Ukrainian army

The Chief of staff of the Armed Forces of Ukraine, General Serhiy Kyrychenko, resigned on 5 October. Health problems were quoted as the official reason for his decision, although the media and experts in Ukraine have pointed out that the deteriorating condition of the Ukrainian army was probably the real motive behind Kyrychenko's resignation. If the president approves the resignation, Ukraine will have vacancies in the country's two most important defence posts (no defence minister has been appointed since June), which is an unprecedented situation. These problems have arisen in a situation where the army is increasingly underfinanced. Defence spending has been reduced considerably this year, and further cuts are expected in 2010. If this trend continues for the next two or three years, the Ukrainian army will lose its combat capability. The crisis in which the Ukrainian armed forces have found themselves is mainly due to the fact that most members of the Ukrainian leadership are not interested in defence issues, and PM Tymoshenko has been pursuing a populist policy in which welfare spending is the priority. The prospect of membership in NATO used to provide an impulse for the army reform which the government saw as a platform of co-operation with the West, but this has now become more distant.

Personnel problems in the army…

The problems with making appointments to key posts in the defence sector started on 5 June 2009, when the Ukrainian parliament dismissed defence minister Yuriy Yekhanurov following allegations concerning irregularities in the ministry. The real reason for the dismissal was presumably PM Tymoshenko's desire to undermine the position of President Viktor Yushchenko, who designates the defence minister in his capacity as commander-in-chief of the armed forces.
On 7 October, the General Staff confirmed media reports that two days previously, Serhiy Kyrychenko had submitted his resignation for health reasons. However, the real reason behind the resignation was presumably Kyrychenko's refusal to accept further cuts in defence spending. President Yushchenko, whose competences include dismissing the Chief of Staff, has stated that he is considering Kyrychenko's request, and that the general's motives are „not simple". The deepening problems with making appointments to key defence posts demonstrate that the army's problems have now become part of the current political strife between President Yushchenko and Prime Minister Tymoshenko.

…in conditions of financial collapse

The Armed Forces of Ukraine have been struggling with insufficient financing for many years, which has been the main impediment to reform. The current economic crisis has resulted in drastic cuts in the defence budget, and left the army in a state of *de facto* financial collapse. In 2005–2008, the proportion of defence spending decreased from 1.3% of GDP to 0.99% (the 2005 armed forces reform programme stated that Ukraine would allocate 2% of GDP to defence purposes).

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This year, the structure of the Defence Ministry's budget was altered in order to conceal the decreasing spending (the Tymoshenko government has been treating the budget as an election campaign tool, and has established welfare spending as a priority when facing finance shortages). The proportion of the so-called special fund in the budget, which consists in the Defence Ministry's revenue from the sale of the army's fixed assets, has increased from over 10% of total spending in 2000–2008 to nearly 30% in 2009. The real amounts obtained from such sales have always been lower than those foreseen in the Budget Acts. Figures on budget implementation in recent years indicate that this category of revenue amounted to around US$120 million annualy in the past. In 2009, the special fund is expected to finance spending of US$527.6 million, although its real revenues will amount to around US$80 million (due to the deep decline of the Ukrainian currency's exchange rate). Moreover, in 2009 the main heading of the Defence Ministry's budget, the general fund, which used to guarantee relatively stable financing, has been cut for the first time. In 2008, the general fund amounted to US$1.6 billion, which has been cut to US$925 million in 2009. At the same time, funding of armed forces reform has been cut radically; this year, the reform is once again to be financed from the special fund, which in fact means that no financing at all will be allocated to army reform.

The 2010 budget assumptions indicate that this unfavourable trend for Ukraine's defence will continue. Out of the projected US$1.6 billion, US$1 billion will come from the general fund, and the remainder from the special fund. Given the macroeconimic indexes used in the preparation of the budget (which are considered to be unrealistic), as well as the problems with obtaining financing from the special fund, total real defence spending will not exceed US$1 billion next year.

Consequences

In 2000–2007, the Ukrainian army underwent a reform programme that was quite ambitious, given the modest financing available. The structure it inherited from the USSR was transformed, and selected units became valuable participants in the US and NATO-led operations which at the same time served as the main point of reference for the modernising Ukrainian armed forces. The financial collapse which has been observed since 2008 will lead to the results of earlier reforms being squandered. Ever more serious shortages in material (including the increasing amount of sales from Ukrainian army stores of its most valuable equipment) and in personnel (the young officers trained to NATO standards are leaving the services), together with the drastic reduction of practical testing-ground training, mean that the new structure of the Ukrainian armed forces which were trained in the middle of this decade will become ineffective. This situation will not only delay the completion of armed forces reform, but also poses a real risk that Ukraine's military potential will be degraded. This in turn may undermine Ukraine's position as a partner in its military co-operation with the West, and also weaken its standing in the relations with Russia.

Natalia Orłowska-Chyż, co-operation: Andrzej Wilk

EVENTS

Hillary Clinton in Moscow: Russia asks for more

On 13 October, the US secretary of state Hillary Clinton paid her first visit to Moscow. The visit generated no measurable progress on the key issues in US-Russia dialogue. It showed, however, that Russia expects the USA to make more concessions with regard to Central Asia and Central Europe, among other fields.

After the meeting of the Russian and US foreign ministers, it was announced that the number of working groups in the Russian-US presidential commission created in July 2009 would be increased to 16. With regard to Iran's nuclear programme, Foreign Minister Lavrov implied that Russia did not support the idea of new sanctions against Tehran at this stage. As concerns missile defence, he said that Russia was now expecting the US side to present the details of the new defence system concept, and that possible future co-operation in this field depended on what those details would be. Previous Russian statements suggest that the parties also discussed the USA's declarations about plans to deploy the Patriot missile systems in Poland. With regard to nuclear armaments, Lavrov and Clinton said that progress had been made in talks concerning the new bilateral disarmament treaty, but did not reveal any details. As regards Afghanistan, Lavrov recalled that the Collective Security Treaty Organisation was awaiting NATO's acceptance of its co-operation proposals. He also announced that Russia expected to be included in the NATO-Central Asia dialogue.

Statements by Russian officials before and after the talks with Secretary Clinton indicate that now that the USA has given up the original missile shield concept, Moscow does not intend to make any gestures to Washington. Instead, it expects the USA to make more concessions, in order to limit or prevent the possibility of the new missile shield being deployed anywhere near its borders (including in Poland), and to have Central Asia effectively recognised as an area of dominant Russian influence. <Men>

Failure of the CIS Summit in Chisinau

An official CIS summit was held in Chisinau on 9 October, with only seven out of the eleven CIS leaders present. Absent were the presidents of Tajikistan, Turkmenistan, Uzbekistan and – most notably – the Kazakh president Nursultan Nazarbayev, who had been considered one of the greatest advocates of post-Soviet integration. He was absent from a CIS summit for the first time. The meeting's atmosphere was defined by the criticism of Russia voiced by some CIS members, and symbolically demonstrated that the member states are attaching less and less significance to multilateral meetings within the framework of the CIS, which remains a completely ineffective structure.

Over twenty documents, which were largely limited to propaganda significance, were signed at the summit, including a plan to tackle the consequences of the global financial crisis, and an appeal on the 65th anniversary of the

Great Patriotic War. The meeting offered an opportunity for Ukraine's president Viktor Yushchenko to criticise Russian policy (his statement was backed by the Azeri and Tajik delegations), and for Belarusian president Alyaksandar Lukashenka to accuse Moscow of failing to provide sufficient financial assistance to those CIS countries which have been struggling with the economic crisis. For Russian president Medvedev, the summit was an occasion to hold several bilateral meetings (including with the presidents of Armenia and Azerbaijan, and the Moldovan presidential candidate Marian Lupu).
Despite the failure of yet another CIS summit, the organisation is not expected to break apart in the immediate future (Russia is not interested in such a scenario). Rather, the fiction that a post-Soviet co-operation structure exists will be maintained. <WojK>

The Kremlin strives to retain its influence in Moldova

The Kremlin used the occasion of the CIS summit in Chisinau (8–9 October) to work on maintaining its influence in Moldova. Intervening subtly in the internal political game in Moldova, Moscow has indicated whom it would favour in a subterrean rivalry for the informal leadership of the ruling coalition. It moved the problem of the frozen conflict in Transnistria to the foreground of its relations with the new government in Chisinau while wooing it with an offer of financial assistance.

The rise to power of a new, pro-European leadership in Moldova has been seen in Moscow as a development which might lead to the loss of Russian influence in this country. The Kremlin has used the CIS summit in Chisinau engage with the new government in Chisinau in order to secure its interests in Moldova. During the summit, the Russian president Dmitry Medvedev signalled that Moscow would support Marian Lupu, the governing coalition presidential candidate. Lupu, while sharing the coalition's objective of integration with the EU, is the most eager among the new leaders to accommodate Russian interests. It is notable that Medvedev refused to meet Prime Minister Vlad Filat, Lupu's main rival in the struggle for informal leadership within the coalition.
By placing the Transnistria issue in the foreground of relations with the new government and by underlining the validity of the Kozak Memorandum (which provides for the federalisation of Moldova with and for Russian military presence for twenty years), Russian diplomacy wanted to demonstrate to the new government that on that issue Russia holds all the cards and to widen the differences within the ruling coalition over its strategy towards Russia.
Meanwhile, the Russian finance minister Alexei Kudrin has announced that Russia is prepared to grant Moldova a US$150 million loan before the end of this year. The loan – unlike the possible IMF loan, would probably not be conditional on the adoption by the Moldovan authorities of unpopular cuts in the welfare sphere, but would come with some political conditions instead.
Russia's message to the new authorities of Moldova is as follows: you can get financial backing if you give up aims that run counter to our interests (such as putting an end to the Russian military presence in Transnistria, or changing the peacekeeping operation's format), and those of you who will be better disposed towards us may expect political support in the fight for power within the coalition.

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Whether or not the Russian tactic proves effective will largely depend on whether the coalition manages to stand united towards Russia, and whether the Moldovan authorities find any alternative to receiving financial assistance from Russia. <wrod>

A symbolic breakthrough in Armenian-Turkish relations

On 10 October in Zurich, the foreign ministers of Turkey, Ahmed Davutoglu, and of Armenia, Eduard Nalbandian, signed the protocols (negotiated with Switzerland as mediator) which provide for the establishment of diplomatic relations and the opening of the Turkish-Armenian border. The signature of the documents marks a symbolic breakthrough in the hostile relations between Turkey and Armenia. However, it does not entail a full normalisation of relations, because in order to enter into force, the documents have to be ratified by the parliaments of the two countries, and no deadline has been set for this ratification. Because of the objections voiced by Azerbaijan and the resistance from nationalist groups in Turkey, Ankara has made the ratification dependent on progress in Armenian-Azeri negotiations concerning the Karabakh conflict, in which major progress is unlikely to happen.

The signing ceremony featured the US Secretary of State Hillary Clinton, the foreign ministers of Russia, Sergei Lavrov, and of France, Bernard Kouchner, and the EU's high representative for the CFSP, Javier Solana. The protocols provide for the establishment of diplomatic relations, the opening of the common border within two months of the protocols' ratification, the start of dialogue on historical issues, and regular intergovernmental consultations. The signature of the protocols is a symbolic breakthrough in relations between Armenia and Turkey, which have been hostile for at least two hundred years, and it proves that some sections of the two nation's leaderships and societies are willing to overcome the divisions. However, this does not mean that diplomatic relations will be established automatically, because of possible problems with ratification in the Turkish parliament. It is not entirely impossible that Turkey will decide to ignore Azerbaijan's objections and ratify the protocols. However, this would imply a *de facto* breaking of the long-standing alliance between Turkey and Azerbaijan, and would create the risk that Baku might seek rapprochement with Russia. The Armenian president Serzh Sargsyan could also hypothetically decide to make concessions on the Karabakh issue, but due to resistance within the Armenian political scene, such a scenario would threaten to destabilise the situation in Armenia (and could even lead to a coup). It is therefore more probable that the ratification of the protocols will be postponed, and the normalisation process in bilateral relations will be stalled. <mf>

CES

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