

EASTWEEK

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

ISSUE 39(189)

18 NOVEMBER 2009

PUBLISHED BY

CENTRE FOR EASTERN STUDIES /

OŚRODEK STUDIÓW WSCHODNICH

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ANALYSES

Medvedev's address: a call for modernisation

President Dmitry Medvedev delivered his annual address to the Federal Assembly and state administration officials on 12 November. The key message of the speech, whose main recipients were foreign investors and the domestic economic elite, concerned plans for a comprehensive modernisation of the Russian state. At the same time, Medvedev sought to present himself as Russia's defender in the international arena, and as a politician who represents the interest of all the major groups in the Russian ruling elite, including its conservative sectors.

While it demonstrates an awareness of existing problems, Medvedev's radical pro-modernisation rhetoric will for the most part remain within the realm of declarations. The lack of political will and the intertwined interests of Russia's numerous lobbies impede any genuine modernisation. Nevertheless, the address proves that the authorities are prepared to adjust selected aspects of the economic policy, as they have been signalling in recent months. The Russian leadership is aware of the need to streamline economic policy in the crisis conditions, and to find new ways to boost the Russian economy's competitiveness, including through foreign investments and technologies.

Political proposals

President Medvedev stated that the political and party system reflected the pluralism of opinion existing in Russia, although he suggested further changes to 'perfect' the election regulations, including measures meant to help smaller parties to operate at the regional level. Some controversial procedures, such as early voting and voting outside the place of residence (which according to observers have been exploited to fix election results) are to be eliminated. President Medvedev had already proposed the first package of amendments to the election regulations in last year's address. The current changes are therefore a continuation of this process. They may also be seen as a reaction to the recent scandal over October regional elections wherein, as a result of numerous irregularities, United Russia, the party of power, scored a massive victory. It should be noted that the changes in legislation will not democratise the Russian election system, because the practices of the authorities at different levels and the election commissions are crucial in this respect. Neither will the changes proposed by Medvedev undermine the hegemony of United Russia on the party scene, although in the future they might restrain the scale of its ballot victories.

Economic proposals

The main subject of the address was the desire to comprehensively modernise the Russian economy and abandon the economic model based on raw materials. Even though many of those radical proposals should be treated as rhetorical, it seems significant that the Russian elite is once more sending

a signal to foreign audiences (especially potential investors), indicating its interest in acquiring foreign investments, and particularly new technologies. This may concern those spheres in which the Russian economy particularly lags behind (such as the extraction sector, in the context of the invitation of foreign investors to participate in developing the gas fields in the Yamal peninsula).

In another important declaration contained in the address, Medvedev signalled a change in the approach to the so-called state corporations (*goskorporatsiyas*), business structures created in the final period of Vladimir Putin's presidency, endowed with enormous autonomy and led by influential members of the ruling elite. In times of prosperity, the corporations were receiving massive amounts of funding from the state. However, they subsequently neither modernised (one example of this being Rostekhnologii, the machine-building and automotive plant corporation) nor developed innovative programmes (as in the case of Rosnano, the corporation that was supposed to develop nanotechnologies). The attempt to limit the autonomy of these state corporations and increase control over their activities (and especially their spending) may be a signal that the Russian leadership is aware of the need to streamline spending in the difficult financial situation.

Finally, an important proposal presented by the president concerned a change in the practice of burning the so called associated gas which escapes during oil extraction. Many Russian oil companies are forced to burn it because they face difficulties with accessing gas pipelines controlled by Gazprom. The president's proposal may therefore be seen as a way to pressure the gas monopoly to allow the oil companies access to its network, since a gas shortage is expected to arise, and the authorities are anxious to make use of the gas extracted by oil companies.

Security and foreign policy

The president did not devote much space in the address to security and foreign policy issues, although the strength of those statements compensated for their brevity. Referring to the Northern Caucasus, Medvedev flatly declared that the authorities would continue 'liquidating bandits' and relentlessly fight terrorism. At the same time, he said that measures would be taken to stimulate economic development in the region, and identified the poor social and economic situation as the main source of problems. With regard to foreign policy, Medvedev reiterated that the existing international security architecture was ineffective, and that Russia would seek to create new platforms for dialogue and decision-making on international issues. On the other hand, he pointed to measures designed to modernise the Russian economy and attract capital, new technologies and ideas as the priority objective of foreign policy.

Conclusions

The main emphasis of Medvedev's address was on modernisation, although the speech also included numerous points which stood in contrast to the liberal economic proposals, such as the affirmation of the political situation in Russia, tough declarations on the fight against terrorism in the Caucasus, the modernisation of Russian arms, and the elements of anti-NATO rhetoric. This indicates that Medvedev was seeking to build his image as a man

who the various groups within the Russian ruling elite can trust, addressing a liberal message to the economic communities and assuring the conservative groups that security issues and Russia's position as a power on the international scene were important to him.

Medvedev's address should be understood as an expression of the elite's intention to streamline the economic policy in crisis conditions, and make the Russian economy more competitive thanks to modern technologies. However, most of the radical modernisation proposals will probably never be implemented, as was the case with the liberal slogans that appeared regularly in the addresses of Medvedev's predecessor, Vladimir Putin. In the case of both politicians, such declarations often testified to an awareness of the problems faced by Russia. However, their implementation was impeded by the lack of political will (this particularly concerns the proposals concerning the development of a modern civil society) and the intertwined interests of the numerous influence groups, including the raw materials lobby.

Jadwiga Rogoża

No IMF support for the Ukrainian budget

On 15 November, the IMF managing director announced that Ukraine, whose authorities have not been co-operating on the implementation of the programme agreed with the Fund, would not receive the payment due in November as part of the stand-by loan (US\$3.8 billion). The programme co-operation may be resumed only after the presidential election. The suspended payment will make implementing the budget more difficult for the government, but will not entail a budget breakdown. Therefore, it will not have a decisive impact on the outcome of the election. However, the budget problems do expose the critical condition of Ukraine's public financing.

Since solving the mounting problems has been postponed until after the election, Ukraine has now found itself in a situation in which dire economic conditions will force any government, irrespective of post-election political reshuffles, to carry out reforms.

The IMF suspends its co-operation with Ukraine

Formally, co-operation has been suspended because the Ukrainian authorities have not been co-operating with the Fund on implementing the memorandum concluded between Ukraine and the Fund (President Viktor Yushchenko's signature of the law elevating welfare standards is one example of this lack of co-operation). In fact, however, the suspension was caused by Kyiv's non-compliance with the Fund's basic principles. The Ukrainian authorities have been ignoring the conditions under which the stand-by loan had been granted: out of the six major points of the programme, five have remained unimplemented. If the IMF paid another instalment of the loan in this situation, the opposition would have very strong arguments for accusing the IMF of following political rather than economic motivations, and of supporting one of the presidential candidates, namely Yulia Tymoshenko.

Yulia Tymoshenko admits failure

The government still formally maintains that the 2009 budget is being executed in 100%, although out of the projected 238.931 billion hryvnia (around US\$30 billion) of budget revenue, only 147.3 billion hryvnia (US\$18.4 billion) has been raised over the ten months of 2009. In order for the budget to be implemented, budget revenue during the last two months of the year would have to be three times the average amount in the preceding period, in a situation in which the government has already made advance income tax collections from companies. Even with spending reduced to a minimum (for example, all VAT reimbursements have been suspended since October, and 86 government programmes are receiving no funding at all), the budget will fall 40 billion hryvnia (US\$5 billion) short at the end of the year. The budget deficit may exceed 8% of the GDP, as PM Yulia Tymoshenko admitted during a meeting with G8 ambassadors in Kyiv on 11 November. Tymoshenko has also confirmed that the government would not have been able to regularly pay pensions, salaries in the public sector or its gas supply dues without the IMF loan payments already received. Moreover, Tymoshenko has admitted that extending co-operation with the IMF is Ukraine's only anti-crisis programme. After the suspension of the programme, Ukraine is unlikely to receive short-term support from other international institutions and Western states, which have made their loans conditional on Ukraine's continued co-operation with the IMF. No support from the European Commission (€610 million), the World Bank (US\$500 million) or the EBRD (the first payment of US\$300 million under the loan to Naftohaz) should be expected until Ukraine resumes co-operation with the IMF.

The imperative to implement the budget

The fourth instalment of the IMF loan (US\$3.8 billion) was to be used to finance the budget deficit. The government will now be forced to seek extraordinary savings and extra revenues to close the 2009 budget, or in fact survive until the presidential election. The IMF has not left the Ukrainian government without any support; it has accepted the conversion of an extra SDR pool awarded to Ukraine in September (the equivalent of more than US\$2 billion), and has authorised the use of the funds thus raised for covering the government's spending. A conversion of US\$1.2 billion was effected in early November, as a result of which Naftohaz was able to pay Gazprom for the gas supplies in October (US\$480 million). The remainder may be used to finance other budget spending. The government may also raise funds by issuing bonds, although the banking sector's liquidity has been so compromised that the Ministry of Finance can raise only several billion hryvnias by issuing bonds bearing interest at 29.5% annually. A money issue by the National Bank of Ukraine (NBU) could be another source of funds. So far, the central bank has been shunning this possibility, although it has already supported the government in critical moments on several occasions before. The value of state treasury bonds in the NBU portfolio has risen to 36 billion hryvnia in 2009. Within the parameters agreed with the IMF, the NBU may still expand the money base by 18 billion hryvnia by the end of the year. Finally, the state-owned banks may also be used to support the government, even if this would

constitute a breach of banking standards. If no unexpected circumstances arise - for instance, if Gazprom does not impose contractual penalties for uncollected gas in 2009 - the budget will be implemented. Thus, the situation of public finance will not have a decisive impact on the election campaign.

Forced reforms

The situation of Ukraine's public finance is a consequence of the policies pursued by the country's successive governments, which have not undertaken the necessary reforms in recent years to optimise the functioning of the welfare system, the pension system and other socially-sensitive sectors. With real revenue at the level of 143 billion hryvnia in 2009, the Ukrainian budget had to provide 44 billion hryvnia (US\$5.5 billion) in support to the Pensions Fund and finance Naftohaz's deficit of 25 billion hryvnia (more than US\$3 billion). The extensive welfare system, which consumes a large portion of the budget, has nonetheless failed to reduce poverty, and the regions have no funds to pay for their gas, heat and electricity supplies because no municipal reforms have been carried out. The economic crisis, which has cut budget revenue, has demonstrated that keeping the current policy may have catastrophic consequences for Ukraine's public finance.

Public debt has been growing rapidly in 2009. Although it still remains within the so-called safe limits and - state guarantees of domestic companies' debt included - does not exceed 40% of the GDP, the dynamics of its growth and the structure of debt are worrying. According to the Ministry of Finance official figures, debt increased from 80 billion hryvnia to 360 billion hryvnia (US\$10 billion to US\$45 billion) over the first 8 months of 2009. The greatest burden is not Ukraine's growing foreign debt (US\$30 billion), but rather the state guarantees issued to economic operators, together with the internal debt. The latter is also the most expensive. The Ministry of Finance has been selling bonds at an interest rate of 24–28% and with maturity dates between 3 to 6 months. This has already created an addition burden of 4 billion hryvnia in the course of this year alone, and more funding will have to be allocated for the redemption of the bonds next year. The Presidential Secretariat estimates that handling the debt will cost the budget as much as the total amount to be spent on education, healthcare and defence.

In this situation, irrespective of what government emerges from the election, it will have to implement reforms to cut budget spending, starting from the liberalisation of gas prices and municipal utility charges, through to reforming the welfare and pension systems. However, it should be underlined that the reforms will not start before the full cycle of elections is over, that is, after the local and, potentially, the parliamentary elections, which may take place in late May 2010.

It is difficult to predict the scope of reforms and the sequence in which they will be implemented. There have been some signals that PM Tymoshenko is preparing to carry out reforms. A reform programme has also been developed by Viktor Yanukovich's Party of Regions, which represents the interests of big business, and therefore is uninterested in saving the budget by increasing the fiscal burden.

Anna Górska

EVENTS

Russia: Nord Stream set to be implemented after Sweden and Finland approve the project

On 5 November, Sweden, followed by Finland, approved the construction of the trans-Baltic Nord Stream gas pipeline within their respective economic zones. The decisions are a turning point in the efforts of the Nord Stream consortium shareholders (Gazprom and Germany's E.ON & BASF) to obtain approvals from the states concerned. Now that the permits have been granted, the project is ready to be implemented. This means that there is no chance of the second branch of the Yamal--Europe gas pipeline (via Belarus and Poland) being constructed in the foreseeable future. Moreover, the launch of the new route, built in order to bypass transit states, will probably lead to a very deep reduction in the amount of Russia gas transit via Ukraine.

Sweden's approval, granted after two years of efforts on the part of the consortium, and after nearly all the changes requested by Stockholm with regard to environmental and security issues were introduced to the project, is crucial for the Nord Stream. However, it is not unconditional. The Swedish government expects construction work to be interrupted in the cod spawning sites for six months during the year (May to October), and wants the investors to take full responsibility for the remnants of military equipment and munitions resting on the sea bottom. Denmark and Finland, the other two states in whose economic zones the gas pipeline is to be routed, have also set conditions, while Helsinki has obtained Moscow's pledge that Russia would not increase export duties on unprocessed timber for one year, in return for the Nord Stream approval. It is certain that approval by the remaining states, Russia and Germany, will be granted. The question of project financing remains open; however, with the proposals from commercial banks and guarantees of the German and Italian state investment agencies in place, this will probably cause no problems for the implementation of the Nord Stream. In Russia's energy strategy, the main objective of the Nord Stream project is to reduce dependence on gas transit via Ukraine. Once the new route is launched with a total capacity of 55 billion m³ a year (planned for 2012), a large portion of the gas currently transmitted via Ukraine will most probably be re-routed via the Baltic Sea. The implementation of the trans-Baltic project also seems to imply that the second branch of the Yamal gas pipeline will not be built. <epa>

Slovenia joins the South Stream

On 14 November, Russia and Slovenia signed an international agreement in Moscow concerning the construction of the Slovenian section of the South Stream gas pipeline, which will provide a direct route for gas supplies from Russia omitting Ukraine through the Black Sea and the Balkans to Central and Southern Europe. The signing of the agreement does not mean that the South Stream will in fact be built. It however seems that the intention of the campaign, which has given publicity for this event in the media, is to propagate the thesis that there is no alternative to the Russian project, considering the gas conflict with Ukraine.

The agreement with Slovenia, the fifth country (after Bulgaria, Serbia, Hungary and Greece) to have given consent to the construction of a South Stream section in its territory, ends the initial stage of intergovernmental arrangements with transit countries located along the route of the planned pipeline. This stage will be closed when the same kind of agreement is signed with Austria, one of the destination countries.

The agreement provides for the establishment of a company in which Gazprom and the Slovenian company Geoplin Plinovodi will hold equal shares whose task will be to develop a technical and economic feasibility study and to design, build and operate the Slovenian section of the pipeline. Gas would flow through Slovenia to northern Italy. During the negotiations, Russia accepted Slovenian demands. In effect, the parity of shares has been guaranteed, the company will be incorporated in Slovenia and will be governed by Slovenian law.

It seems that the agreement with Slovenia, which Moscow presents as significant progress in the implementation of the South Stream, will be used as an argument in Russia's negotiations with Ukraine before signing a new gas deal and at the same time as confirmation of the Russian project's advantages as an alternative to gas transit through Ukraine to Europe. Such conclusions seem to be justified because the publicity given to this event is accompanied by warnings addressed by Russian politicians to Europe, according to whom problems with gas supplies will be inevitable in the case of Ukraine's inability to settle the accounts with Gazprom. This is also intended to prove that the Russian project is more advanced than its competitor, Nabucco. <epa>

Gazprom still seeks to take over control of Ukraine's gas pipelines

On 12 November, the *Ukrayinska Pravda* online newspaper published a Russian draft of the intergovernmental agreement on gas co-operation with Ukraine, the signature and implementation of which could assist Gazprom in taking over control of the Ukrainian gas infrastructure. The document in the shape proposed by the Russian government should be unacceptable to any sovereign government. However, Ukraine is under pressure as it faces possible contractual penalties from Gazprom (which could run into billions). In this situation, it may be forced to make more concessions to the Russian partner.

The draft document published would regulate the Russian-Ukrainian gas co-operation at governmental level until 2030. It is odd, from the point of view of equality of sovereign partner states, as it only lays down obligations for Ukraine. In addition, it takes away the Ukrainian government's right to defend its property, and makes an arbitration court in Moscow the competent body for the resolution of all disputes. Russian officials have indirectly admitted that they had presented such a draft to the Ukrainian side, but they made the reservation that it only represents Russia's initial position, and that negotiations concerning the new agreement, initiated by the Ukrainians, have been underway since April. So far, agreement has been reached only with regard to Russia's participation in the modernisation of Ukraine's gas pipelines. Ukrainian prime minister Yulia Tymoshenko's comments have been limited to stating that control over gas pipelines will not be ceded.

The final shape of the agreement will probably only be decided after the presidential election in Ukraine. For the moment, the Kremlin is refraining from any action that could be interpreted as favouring or opposing any of the presidential contenders. However, Russia will be able to use a very strong argument in its negotiations with Ukraine, i.e. the ability to impose contractual penalties for uncollected gas in 2009. According to various estimates, the penalties could reach as much as US\$7.8 billion, and Ukraine is not in a position to repay such a debt. <AnG>

Moldova and Romania sign agreement on visa-free local border traffic

The agreement on local border traffic, signed on 14 November by the prime ministers of Moldova and Romania, Vladimir Filat and Emil Boc, will enable around one-third of the Moldovan population to enter Romania without visas. Its conclusion marks another step by the new pro-European government of Moldova towards developing closer relations with Romania, which the new leadership considers Moldova's key partner in the policy of gradual integration with the European Union. The agreement was signed during PM Filat's two-day visit to Bucharest, which abounded in gestures underlining the cultural, linguistic and historical ties between the two countries.

Under the agreement, Moldovan citizens with permanent residence within the fifty-kilometre border zone will have the right to enter the fifty-kilometre border zone of Romania without visas, holding only a special document. The documents will be issued free of charge by Romanian consular offices, and will be valid for two to five years. The border zone consists of 651 villages and 369 municipalities, with a total population of 1.2 million (approximately one-third of the total population of Moldova).

For many Moldovans, the agreement's entry into force will alleviate the consequences of the visa regime introduced by Romania in 2007 in connection with its accession to the EU. The previous, communist government of Moldova had repeatedly postponed the signature of the agreement, fearing that it would boost Romanian influence in Moldova.

The new Moldovan leadership has previously authorised the establishment of two Romanian consulates in Balti and Cahul, and has currently proposed the creation of a third in Ungheni. Moldova is also advocating abolition of the requirement for Moldovan nationals to hold €500 when entering Romania. Romania has already lifted the yearly consular fee of €120 that was charged to Moldovans studying in Romania.

The signature of the present agreement is part of an emerging joint strategy by the Moldovan leadership and the Romanian government, aimed at integrating Moldova within the European space by developing closer relations between Moldova and Romania through small steps. <wrod>

Azeri authorities fear youth activity

On 11 November, two young opposition activists and popular bloggers, Adnan Hajizade and Emin Milli, were sentenced to two and two and a half years respectively in prison for hooliganism. The verdict appears to have been politically motivated. The bloggers' case demonstrates that the Azeri authorities are adopting a tougher course on freedom of speech,

and that the regime is increasingly concerned about the growing political activity of young people which has been observed in recent months.

Adnan Hajizade is one of the founders of the "OI!" ("Be!") opposition youth organisation, and Emin Milli is the co-founder of the Alumni Network organisation. Both have been active advocates of democratisation and have co-operated with human rights organisations. They have also run popular blogs in which they strongly criticised the Azeri authorities. The two activists were arrested in July in a Baku restaurant on charges of having started a fight. Both the defendants and a number of Azeri and international human rights organisations claim the fight was a provocation and the arrest was politically motivated. In their opinion, numerous procedures were violated during the trial, and the sentences are excessively severe. The convictions have been criticised by the US Department of State and the Council of Europe. The verdict proves that the Azeri authorities are consolidating their authoritarian political system and ignoring their international human rights commitments. It is also an expression of the Azeri regime's concern about a possible mobilisation of pro-democratic young people, especially students in the capital city's universities. While youth activity is currently taking place mainly in virtual space (numerous blogs, opposition portals or forums hugely popular with young people), the authorities fear it could transform into real opposition activity. <mf>

Bulgaria's chance for Azeri gas supplies is growing

The state-controlled gas firms, Azerbaijan's SOCAR and Bulgaria's Bulgartransgaz, signed a memorandum establishing a joint venture to check the feasibility of Azeri gas supplies to Bulgaria during the visit of Azerbaijan's President Ilham Aliyev to Sofia on 13 November. This is the first decisive step towards improving Sofia's energy security and lessening its total dependence on Russian gas supplies.

The joint venture will carry out a feasibility study regarding the transport of Azeri gas to Bulgaria. One of the options is to transport gas via Turkey and further via the planned branch of the TGI (Turkey-Greece-Italy) gas pipeline, which is now under construction, to Bulgaria or via the Nabucco gas pipeline. Sofia has announced for the first time that supplies of compressed natural gas (CNG) by ship to the Bulgarian port of Varna is one of the considered variants. An international memorandum envisaging supplies of 1 billion m³ of gas annually was also signed during Aliyev's visit. However, the date of commencement of such supplies was not determined.

The agreements signed are Sofia's greatest achievement on its way towards the diversification of gas supplies so far. Bulgaria, which is entirely dependent on Russian supplies, has intensified its efforts to receive supplies from the Caspian region after the gas crisis this January. This August it received a promise of future supplies reaching 2 billion m³ of gas annually from Turkmenistan. Now it seems that its chances for Azeri gas supplies have significantly increased. At the same time, the signed agreements, especially the possibility of CNG supplies, may be interpreted as one more element of Baku's strategy of reducing the role of Turkey as a transit country in its Azeri supplies to the European market. <dab>

CES

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