



ICPS

International
Centre
for Policy
Studies

4 Borys Hrinchenko st., office 3, Kyiv, 01001, Ukraine
Phone (380 44) 279-88-23 | office@icps.kiev.ua | www.icps.com.ua

Foreign Policy Insight

October 22, 2014
Issue 9

Contents

Foreign Policy Strategies and Decisions	1
• The 10 th Asia — Europe Meeting Summit in Milan: no war, no peace.	1
• German spy games around Malaysian airliner	2
Energy Diplomacy	3
• Preferential trade with Ukraine will be given the green light	3
Economic Diplomacy	4
• Sanctions make Russia enhance its cooperation with China.	4
• International organizations are willing to increase aid to Ukraine	5
• Energy autonomy of Donbas: reality or myth?	7

Foreign Policy Strategies and Decisions

The 10th Asia — Europe Meeting Summit in Milan: no war, no peace



On 16-17 October 2014, the 10th Asia-Europe Meeting (ASEM) Summit took place in Milan. The Summit takes place every two years and brings together Heads of State and Government from 51 Asian and European countries. The main purpose of the ASEM Summit is to discuss commercial and economic relations between countries, security issues etc. This time the focus of discussion was shifted onto Ukraine. Thus, «Ukrainian case» became the main subject of the two-day ASEM Summit.

The fact that both Ukrainian President Petro Poroshenko and Russian President Vladimir Pu-

“Ukrainian case” became the main subject of the ASEM Summit in Milan

tin accepted an invitation to attend the Summit is definitely a positive thing about the Summit. Until the very end of the Summit, no one knew how things would turn out. Predictions of the Summit outcome kept changing all the time. However, no country agreed to change its position. If we wave aside all diplomatic rhetoric on the achieved progress, which was void of established facts, we should acknowledge that the Milan Summit on “Ukrainian case” was a complete failure. All diplomatic efforts to reach an agreement ended in failure. The well-known Normand format with the participation of British and Italian Prime Ministers, the so-called “wider” format, and a tête-à-tête conversa-

No country changed its position during the negotiations

tion between Ukrainian and Russian leaders failed to yield positive results.

In view of Ukrainian President's statement that "Ukrainian delegation fulfilled its mission in Milan", we can conclude that prior to this Summit, amendments and supplements to the so-called Minsk agreements were discussed, which would allow Russians to consolidate their positions in Donbas for decades. Taking into account that it was not possible for Ukraine to reach a desired political outcome, the preservation of the status quo is a positive thing.

But what is next? The escalation of hostilities in Donbas over the last days is a clear manifestation of Kremlin's discontent over the outcome of Minsk negotiations. The situation may even get worse in the near future. The upcoming winter makes Russia precipitate the resolution of the so-called "Crimean issue". Since the closure of the Kerch Strait ferry line will compound supplies to the peninsula, the land corridor is considered as the last alternative. This

will open the door to large-scale military actions, which, apparently, both sides are preparing for.

In the situation where the threat of war hangs heavily over Europe, the passivity of the US comes as a surprise. In view of the fact that no military and political conflict has been resolved without American interference over the last two decades, the disengagement of Obama's Administration from Ukrainian-Russian confrontation is an alarming signal. In order to preclude a large-scale catastrophe in Europe, it is necessary to do everything possible to ensure that political regulation translates into the "Geneva +" format with the US participation. In addition, the Kremlin is looking forward to Barack Obama joining round-table negotiations. All other formats of negotiations are used by Russia only as an instrument for conserving the existing situation.

It is in Russia's interests to engage the US in negotiations

German spy games around Malaysian airliner

The deliberate leak on Malaysia Airlines MH17 crash in the German media was quite unexpected, with German Federal Intelligence Service being the news source. According to a German magazine "Der Spiegel", German Intelligence concluded that pro-Russian separatists downed Malaysia Airlines Boeing 777 over the Donetsk region. As "Der Spiegel" claims, this is what President of German Federal Intelligence Service Gerhard Schindler told members of the Bundestag parliamentary controlling body on October 8, while presenting compelling evidence.

Pro-Russian separatists used "BUK" air defence missile system to shoot down the Malaysian airliner

According to Mr Schindler, pro-Russian separatists shot down the plane by a missile from "BUK" air defence missile system, which they captured at one of Ukrainian military bases. As a result, on June 17, the Malaysian airliner crashed while en route from Amsterdam to Kuala Lumpur.

Ukraine's response to such allegations was prompt. Ukraine reiterated that no "BUK" air de-

fence missile system has been captured from its military bases. Nevertheless, the fact remains that a brilliant operation has been launched with the aim of diverting public attention from Donbas events and implying that Ukraine had no control over its own army and failed to prevent the seizure of heaven weapons by pro-Russian bandit groups.

Two moments can be singled out here. Firstly, the very incident took place at a moment when public debate on whether Germany should send German military personnel to Ukraine to handle drones to be handed over to the OSCE is becoming more intense. Secondly, there is no official position of the German government on the revealed information.

In view of the interweaving of interests around Ukraine, it can be concluded that it is the first but not the last spy scandal. We can only hope that neither this scandal, nor any other future scandal will cause the tension between Ukraine and its European partners.

European focus

Preferential trade with Ukraine will be given the green light

On Monday, the Committee on International Trade (INTA) of the European Parliament voted for prolonging of the autonomous trade preferences for Ukraine after the first vote on the trade preferences was blocked. In accordance with the autonomous trade preferences regime, Ukraine is exempt from customs duties when supplying its goods to the EU countries.

Thus, there are good chances that all necessary legal procedures will be finished by November 1, 2014. The European Parliament will have enough time to make the final decision.

The European Parliament has enough time to make the final decision

It should be noted that this decision was adopted against ambiguous events playing out around the

group in the European Parliament (EP), which was labelled “Putin’s friends”. On Thursday, Iveta Grigule resigned from the right-wing Europe of Freedom and Direct Democracy group. Accordingly, in case the Europe of Freedom and Direct Democracy group does not get one representative from one of the EU countries in the near future to replace Ms Grigule, the group will be dissolved. According to the European Parliament rules, it takes a minimum of 25 members from 8 countries to form political factions in the European Parliament.

Some political observers already named such an event as the “defeat of Eurosceptics” and “Putin’s failure”. However, Russian lobbying capabilities should not be underestimated. The Kremlin will not stop stirring pro-Russian sentiments in various EU member states as well as EU institutions.

Regional and global focus: implications for Ukraine

Sanctions make Russia enhance its cooperation with China



Russia's international isolation in the aftermath of the Ukraine crisis prompted Russia to enhance its cooperation with China to attract investment and prevent a painful economic recession. Following its confrontation with the West, Russia became dependent on China's political support. However, the strategy for political rapprochement with Beijing is fraught with risks and complications.

Russia is becoming politically and economically dependent on China

Since the Russian currency hit a new all-time low against the dollar with foreign investment decreasing, Chinese capital may only deepen Russia's dependence on natural resources and prevent the Russian government from diversifying Russian economy. In turn, China will take the opportunity to get maximum advantages out of the current geopolitical situation.

During the working visit of Chinese Prime Minister Li Keqiang to Moscow on October 12-14, a package of agreements on energy and finances were signed, in particular the agreement on currency swaps between the Central Bank of Russia and People's Bank of China worth USD 25 billion, the agreement on the prevention of double taxation and fight against tax evasion, the cooperation agreement on Russian natural gas transported through the "Power of Siberia" natural gas pipeline. It should be noted that the "Power of Siberia" is a joint Russian-Chinese project, which provides for the construction of a trunk gas pipeline to transport gas from Yakutia to Primorsky Krai and Pacific Rim. In May 2014, this project was given impetus in connection to signing of a new USD 400 billion gas contract between "Gazprom" and China National Petroleum Corporation (CNPC). Under this contract, Russia has to supply 38 billion cubic meters

of natural gas to China each year. The size of investment in this project amounts to USD 55 billion.

However, Chinese banks and investors do not hurry to risk on ensuring financial inflows, which Russia needs so desperately. Since major Chinese banks have strategic interests in many countries, they cannot allow themselves to help Russia evade American and European sanctions. «Discretion» policy is clearly reflected in credit ratings. At the beginning of September, a corporate credit portfolio of Industrial and Commercial Bank of China (ICBC) in Russia totalled RUB 3.35 billion (USD 83 million). Bank of China's loans to Russian companies amounted to RUB 2.15 billion (USD 52.6 million), while China Construction Bank's outstanding loans to Russian companies totalled RUB 1.3 billion (USD 31.8 million). These figures seem negligible in comparison to USD 134 billion worth of foreign debt, which Russian banks and corporations have to pay off to American and European banks by the end of 2015.

Russian companies were also faced up with problems with trade finance and financial transaction management. These are the spheres that actually prompted Russian companies to ask Chinese banks for help. Chinese creditors consider all possible risks, a manifestation of which is the fact that the Central Bank of China monitors money transfers from Russian organizations to ensure that such

Chinese investors do not hurry to invest in Russian economy

money transfers are in no way linked to companies or oligarchs, which were blacklisted by the EU and the US.

By deepening its dependence on China, Russia runs the risk of eventually getting a mighty neighbour in Pacific Rim and speed up its economic recession. In view of the fact that Russia is going to meet China's key military demands, enhanced cooperation between these two states may have repercussions for other countries. Such developments may cause an arms race as well as growing concerns among East Asia's countries. In particular, Russia intends to purchase Chinese high technologies. Moreover, it is planned to sign agreements between Russia and China on supply of S-400 missile systems and SU -35 destroyers. Russia may also start supplying its newest submarine "Amur 1650" to China. Despite the fact that Moscow still remains China's major weapon supplier, for decades Russia has restrained itself from supplying the Middle Kingdom with the best systems and technologies. However, the sanctions imposed on the Russian Federation corrected and changed the situation.

Moscow's efforts to improve "strategic partnership" with China are portrayed as a counterbalance to Western pressure and a guarantee against international isolation. In fact, it handicaps and puts Russia in a vulnerable geopolitical position, as well as gives rise to risks that Moscow cannot handle.

Russia risks to hasten its economic recession

International organizations are willing to increase aid to Ukraine

Last week a number of international organizations have expressed their willingness to continue cooperation with Ukraine and increase financial and technical aid to Ukraine. It is expected that one portion of the funds will be aimed at macro-economic assistance, and another one — at reform implementation, technical assistance, restoration of Donbas and the real economy sector.

In particular, the head of the National Bank of Ukraine Valeriya Hontarievna expects that international financial or-

Ukraine expects \$ 19 bln aid from international organizations

ganizations will allocate \$ 19 bln for the projects in Ukraine. This was announced after her working trip to Washington. Valeriya Hontarievna also argues that the current IMF program for Ukraine does not require correction and certain financial support may be clarified next year. In turn, the Ministry of Finance expects to receive additional \$ 250 mln from the World Bank for development policy by the end of 2014. It is expected that in the future donor assistance from the World Bank will be embodied into a "sin-

The World Bank is going to allocate USD 1,25 bln for reform support in Ukraine

gle platform”. It would allow to structure cooperation between WB and Ukraine more precisely.

It should be noted that in September the World Bank announced its willingness to allocate \$ 1,25 bln in order to support reforms. A new aid package will include two reform support projects that should contribute to economic growth and stabilize banking sector, as well as investments projects to support modernization of district heating, social security system improvement, development of urban infrastructure and agriculture.

Ukraine continues fruitful cooperation with the European Bank for Reconstruction and Development in various fields. In particular, preparation of an ambitious cooperation program has begun. It includes banks recapitalization, commercial financing of reverse gas supplies, providing credit resources and direct investment. This program involves the active use of FX swaps and repos between EBRD and the National Bank of Ukraine, as well as the establishment of a private equity fund for Ukrainian companies with substandard risks.

The agricultural sector is another area of interest for EBRD in Ukraine. In 2014, EBRD invests EUR 300 mln in its development. As of October 7, 2014, 12 projects with a total investment of EUR 240 mln have been launched. It is expected to implement projects with estimated value of EUR 60 mln. EBRD also plans to reduce the financial threshold for considered proposals and invest in projects with a budget from EUR 2 mln, and not EUR 10 mln, as announced earlier. In general, in 2014, EBRD invests up to EUR 1 bln in the projects in Ukraine.

In 2014,
EBRD invests
around EUR 300 mln
in Ukrainian
agricultural sector

Intensification of cooperation between Ukraine and the European Investment Bank has been observed. In particular, six new programs are going to be implemented soon. The projects on infrastructure reconstruction in eastern Ukraine and meeting the main needs of IDPs are of top priority. As the first step, it is proposed to give Ukraine a joint loan that does not require detailed form. In addition, in order to implement this project, EIB aims to enlist cooperation from other financial institutions. The most anticipated contender for cooperation is EBRD.

In addition, the UN also plans to increase aid for Donbas restoration. This was announced at the

presentation of the third phase of the EU / UNDP project “Community Based Approach to Local Development”. It is expected to grant more than USD 700 000 to the local communities to support projects aimed at restoring the region. UNDP together with the EU plans to support community projects aimed at restoring eight districts of Donetsk region, which are considered to be relatively safe, as well as to support cities to accommodate internally displaced persons (IDPs). In addition, a joint project of UNDP and the EU will implement the program of reintegration of IDPs.

Japan also expressed its willingness to finance the restoration of Donbas. Tokyo is providing Kyiv with assistance of USD 1,5 bln. In addition, Ukraine is going to receive USD 6 mln for restoring infrastructure in eastern regions of Ukraine and USD 1 mln for medical aid to civilians aggrieved during the hostilities in Donbas. Japan also plans to develop cooperation in the field of nuclear facilities safety, energy and investment, as well as to support Ukraine’s bid to join the forum “Asia-Europe”.

Japan aims at
developing energy
and investment
cooperation with
Ukraine

Ukraine counts on strong financial support from the international community, as the material losses caused during Russia’s military aggression against Ukraine can not be compensated entirely by internal resources. Preliminary estimates of direct material damages of Ukraine amounts from UAH 8 to 20 bln. However, it should be taken into consideration that despite the truce, hostilities continue. As a result, transport and social infrastructures, residential properties and manufacturing facilities are being destroyed. Thus, the total amount of losses can be calculated more precisely after a complete ceasefire and establishment of control over territories. According to our estimates, the amount of direct material losses could reach USD 10 bln. Another expenditures cover financing resettlement and providing jobs for IDPs — persons from the ATO zone.

It is planned that restoration of Donbas infrastructure will be carried out at the expense of a special state budget fund and non-state special fund to be filled with contributions from other countries. The special fund will be filled from three sources of

Petro Poroshenko
expects to raise
USD 1 bln for
Donbas restoration

funding: Ukrainian business, donor assistance from other countries and the state budget. The President of Ukraine Petro Poroshenko expects that USD 1 bln is going to be raised.

The government together with EU partners is developing the Plan for Ukraine's recovery for 2015-2017. It will include the restoration of the destroyed infrastructure of the East as a separate block. The document will be released in late November, and in

January 2015, it is planned to hold a large-scale investment and donor conference in order to coordinate international and Ukrainian efforts as regards restoration of the affected territories.

A crucial issue to be addressed simultaneously with external donor assistance obtaining is fighting against corruption. Corruption can significantly negate positive effect of receiving financial and technical assistance.

Energy autonomy of Donbas: reality or myth?

It seems that the Ukraine-Russia gas conflict is just a local phenomenon, but such vision of a situation is superficial. The energy conflict between Ukraine and Russia may be a part of global economic processes. Any local political turmoil have financial implications in the world economy. Frequently, terrorist acts in one part of the world cause the collapse of stock indexes in the other. At first glance, no sharp large-scale transformation because of the Ukraine-Russia gas conflict has been observed in global markets. However, escalation of the conflict in eastern Ukraine, Malaysia Airlines plane crash and imposing of the European and American sanctions against Russia's energy sector along with other global factors have become a prerequisite for the drop in world oil prices. The abovementioned complex of unfavorable foreign factors has a direct impact on weakening of the Russian Federation's political and economic strength. Despite the pressure of international community and aggravation of the situation around Russia, the Kremlin continues to conduct destructive foreign policy towards Ukraine.

Recently, leaders of "LNR" and "DNR" (Luhansk People's Republic and Donetsk People's Republic) terrorist groups have announced that they were conducting negotiations with the Russian government as regards gas supplies and building of power lines from Russia. Actually, the Russian side can implement the so-called Transnistrian option in the territories controlled by separatists. Currently, unrecognized Transnistria receives gas intended for Moldova, but does not pay for it. Transnistrian debts are included in the

The Russian side can implement the Transnistrian option in Donbas

total gas debt of Moldova. In a situation with "LNR" and "DNR", two options are possible: the first one — Russia will increase the Ukraine's gas debt according to the Transnistria scenario; the second one — the Kremlin will supply gas to the region as humanitarian aid that will strengthen the pro-Russian sentiments among the local population.

Theoretically, separatists have an opportunity to arrange direct gas supplies with the Kremlin and establish "energy autonomy of Donbas", but technically, it is extremely difficult to implement this project. It requires time, money and most importantly — qualified experts. It is impossible to establish autonomous energy system (electrical and gas systems) during a limited period of time.

Instead, separatists' attempts directly threaten the stable operation of the Ukrainian GTS. The gas pipeline "Soyuz", which provides 25% of Russian gas transit to Europe, runs through the conflict zone. This gas pipeline ensures hydrocarbons supplies to a number of Ukraine's regions. There are Verhunsk and Krasnopopivsk gas storage facilities in the conflict zone. They allow for storing 200 mln cubic meters of gas and were used to supply gas to Luhansk and Donetsk regions. It leaves no doubt that terrorists may block the stations at any time that will allow Russian "Gazprom" to accuse Kyiv of siphoning off transit gas, discredit the security of gas transit through Ukraine and halt gas supplies to Europe. Moreover, the biased information propaganda has been carried out in Russia since September 2014.

The gas pipeline "Soyuz", which provides 25% of Russian gas transit to Europe, runs through the conflict zone

The aim of the publication is to provide analysis of Ukraine's foreign policy in the context of global processes in the region and the world, as well as an overview of major world events that may have an impact on the further development of Ukraine and the region. Special attention is paid to the European integration of Ukraine, in particular implementation of Ukraine–EU Association Agreement.

@2014 International Centre for Policy Studies (ICPS)

If citing please give reference on the ICPS

Idea of the project: Vasyl Filipchuk

Responsible for the project: Vadym Triukhan

Team of ICPS experts: Vadym Triukhan, Volodymyr Prytula, Iryna Ivashko, Olena Zakharova, Nataliia Slobodian, Vasyl Povoroznyk

ICPS experts are open to communicate with media. To receive professional comments on the issues covered by Foreign Policy Insight publication please contact Communication Director Ms. Svitlana Sudak at ssudak@icps.kiev.ua