

**ECONOMICS AND
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NATO Parliamentary Assembly

**SUB-COMMITTEE ON EAST-WEST ECONOMIC
CO-OPERATION AND CONVERGENCE**

VISIT TO WARSAW, POLAND

SECRETARIAT REPORT*

27 & 28 APRIL 2006

International Secretariat

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* This Secretariat Report is presented for information only and does not necessarily represent the official view of the Assembly.

1. From 27 to 28 April 2006, members of the Sub-Committee on East West Economic Cooperation and Convergence travelled to Warsaw, Poland, to discuss a range of issues including Poland's relations with Ukraine, Belarus, and Russia, Poland's views of the European Union and its role in the transatlantic alliance and energy security matters.
2. Poland has a special perspective on Russia and Ukraine, in part, because of a common Slavic identity, common experiences under Communism, geographical proximity and historical ties. Poland's relationship with Russia is particularly complex and involves both close cooperation and tension. Polish authorities who met with the members of the Committee stressed that they seek good working relations with Russia and sense that there has been a great deal of progress in recent years, perhaps capped by a recent visit of President Putins' chief foreign policy adviser to Warsaw. There are also growing cultural ties between Russia and Poland; Russian music, literature and film are all well received in Poland and vice versa. But there are important differences as well.
3. Like much of Europe, Poland recognizes that Russia is a key supplier of energy and it wants to be a reliable transport power partner to Russia so that Russian energy can move to Europe. At the same time, Polish authorities recognize that supply diversification is critical to national security. Polish authorities were upset by the German-Russian agreement to build a Baltic pipeline because other European countries were not consulted. Poland wants to see a European energy policy implemented that accords Russia a prominent role as a supplier but not as the sole supplier to any particular country. It also wants to encourage Europe to speak with one voice on energy matters.
4. The Polish believe that Russian leaders see oil and gas as profoundly political assets and suggest that the cut-off of Ukrainian gas last winter reflected Russian political as well as economic interests.
5. Poland has also faced a Russian import embargo on certain food exports, claiming that Poland did not meet its certification standards on a range of goods. The EU Commission has supported Poland's view on this and the matter is likely to be resolved soon.
6. Russian support for the Belarusian dictator Lukaschenko poses another problem in Russian-Polish relations. Poland wants a democratic Belarus on its borders, and sees Alexander Lukaschenko's regime as a grim and grotesque example of political authoritarianism and a living monument to the worst excesses of the old Soviet system. Although the recent elections were tightly controlled and thoroughly undemocratic, they also revealed a public aspiration for democracy. Poland supports the visa ban that both the EU and the U.S. have imposed on Belarusian leaders and wants intelligent economic sanctions imposed against that country. Poland maintains some contacts with the government as it is an important transit country and because there is a significant Polish minority living there who has suffered mistreatment in recent years. Polish authorities argue that new and innovative ways are needed to engage democratic figures and civil society in that country. There is a strong view that Belarusians should be able to secure travel visas to come the West: New visa fees will make it virtually impossible for many Belarusians to travel to Europe. If anything, travel can help spark a democratic movement there and block Lukaschenko's efforts to isolate his own country. Thus any sanction regime should not strike at the public but rather at the elites serving the authoritarian interests of the regime.
7. Polish-Ukrainian relations are very strong, and Poland has welcomed Ukraine's democratic evolution. It is not coincidental that President Lech Kaczyński paid one of his first state visits to Poland. Poland has become an advocate of Ukraine's integration in the Euro-Atlantic system and has appealed to its partners in the EU and NATO to rally to Ukraine's support. It is also urging Ukraine to take advantage of every opportunity it has been extended in the EU's Action Plan. Ultimately Poland would like to see a democratic Ukraine prepared for full accession to the EU and

has suggested that one way to make this possible is to establish a more advanced Association agreement between the EU and Ukraine.

8. That said, recent elections in Ukraine did not turn on EU issues. In fact part of Ukrainian society feels disappointed with the EU and the relationship has not evolved significantly, from their perspective, since the Kuchma years. There is clearly a need for deeper contact between Ukrainian society and EU members, and some of this is envisioned in the Action Plan.

9. Akadisuz Sarna of the Center for Eastern Studies spoke at length on Ukraine's economic situation. He noted that, last year, Ukraine's economy slowed considerably after several years of dramatic expansion. This deterioration was due to political factors and a weakening of export markets. The slowdown in external demand was also related to the re-evaluation of the Hryvnia which was undertaken to brake inflation but which also raised the prices of Ukrainian exports.

10. The larger problem has been the lack of agreement on Ukraine's transition model. Ukraine has lacked a coherent export strategy. When Yulia Tymoschenko became Prime Minister, she adopted one of the most socially oriented budgets in the history of Ukraine. It placed a premium on social spending at the cost of investment. The rise in income crowded out investment and a policy of reprivatisation was also seen as undermining the investing classes. Mrs Tymoschenko promised to review over 3000 privatisations, and there were no coherent laws to regulate the process. That said, the recent sale of the Kryvorizhstal Steel Plant generated large earnings for the state. But the general effect was to discourage investment. Only towards the end of the year with the change of government did the situation begin to stabilize. The banking sector, in particular, is attracting the interest of foreign investors. Germany is the leading investor in Ukraine while Russian investment is surprisingly low given its own ties to the country. Cyprus and the Virgin Islands are also leading investors, which is indicative of how money from the grey economy is being recycled back into Ukraine. The grey and black market could account for as much as 40% of GDP. This also suggests that the role of Russian money in Ukraine is likely far greater than official statistics suggest. There are also signs that official Russian investment activity in Ukraine is picking up.

11. Although a coalition has yet to be established for the new government, any possible coalitions looks set to be shaky. There is a general sense that reform would remain on the agenda although there could be a temptation to engage in economic populism in ways that might slow down the pace of reform.

12. There are also large risks in the Ukrainian economy. The gas war with Russia revealed Ukraine's grave energy vulnerability. Although Russian and Ukrainian negotiators signed a deal to settle the problem, there are strong intimations that Russia wants to reopen talks. Ukraine is in a vulnerable negotiating position and there is a sense that tensions between the two countries could rise again. To a certain extent, this, like lingering fears of renewed reprivatisations, is clouding the country's economic future. Polish officials are perfectly aware that Gazprom announced gas price increases in Ukraine prior to national elections while only waiting until after the Belarus elections to announce their intention to raise prices in that country. Moreover the day before the gas crisis, Russia banned meat and milk products from Ukraine and had imposed similar trade restrictions on Georgia and Moldova. It is not surprising that Ukrainian diplomacy has been very sympathetic to both countries and that Yuschenko himself has been highly engaged in the Transdnister peace process. Ukraine has also adopted the EU's line on Belarus although it sees itself playing a role as an intermediary should the situation evolve to the point.

13. There are also concerns about inflation and since the Party of the Regions is a party of exporters, its inclusion in the coalition could result in pressures to devalue the currency, which would, in turn, further stoke inflation. Ukraine's large industry flourishes on cheap raw materials, low labour costs and strong export margins. The metallic industry generates 40% of Ukraine's

revenues. In 1996 that sector began a significant expansion and began to tap into new markets including China. Energy price rises are already cutting into the country's competitive advantages. Ukraine's fiscal system is still in need of reform.

14. Gzegoryz Gromadzki of the Batory Foundation addressed Poland's relations with her neighbours. Poland was acutely aware of the importance of Ukraine's recent democratic election. The contrast between Ukraine's elections and the rigged elections of Belarus could not be greater. The high turnout in Ukraine suggested that there has been a sea change in that country and that it has embraced democracy in a genuine fashion. Those elections also showed a degree of stability in the support for the three main parties as well as a persistent geographic division. The fact that Mrs Tymoschenko outpolled "Our Ukraine" in many regions of the West underlines the strength of her party.

15. The parliament in Ukraine now only has five parties and ensures a degree of order in the Ukrainian Duma. There will be no extreme left or rightwing parties in the government and hard line nationalists will not be present either. The great challenge now lies is building a coalition. This problem is rendered all the more challenging as "Our Ukraine" resolutely refuses to accept Mrs Tymoschenko to head the new government. There are also strong reasons for including Viktor Yanokovich and the Party of the Regions in the government simply because this would mean that both the East and the West of the country would be represented. The worst option might be a broad coalition because Ukraine needs a vibrant opposition if it is to move forward. It is also simplistic to maintain that the Party of Region's is simply a pro-Russian front. That party is run by a business oligarchy that in many ways looks at Russia as a source of unwanted competition. The Eastern business establishment actually has a growing economic interest in the West and is increasingly trading and investing in the EU. In this sense, concerns about secession are greatly exaggerated. The eastern regions of Ukraine are not eager to become part of Russia and they would hardly appreciate interference from the Kremlin in their affairs.

16. The real test for the new government will lie in its capacity to sustain reform. Without significant policy changes, Ukraine will not be able to move closer to the West. In this sense WTO membership could be very helpful insofar as it helps to discipline the reform process. The prospect of WTO accession has indeed hastened a range of economic reforms and Ukraine is moving towards its goal of membership. But the public has not been involved at all in the discussion about membership and what this will entail.

17. Energy Security emerged as a key theme of the discussions and Piotr Naimski, the Secretary of State from the Ministry of Economy made this the focus of his talk. He noted that European energy policy was difficult to discuss before January of this year. Neither the EU nor NATO had a common energy policy, and there had been an assumption throughout the West that market forces would more or less sort out energy matters.

18. The sequence of events in early January changed perceptions markedly. First Moscow began to ratchet up political pressure on Ukraine on a range of issues and then gas supplies were lowered. A dramatic fall in temperatures in Siberia ensued and Russia suddenly could not meet market demands. At the same time, a key pipeline blew up in Georgia plunging that country into a sudden energy crisis. All of this conspired to render Russian reliability suspect. This chain of events is indeed worrisome and has rightfully pushed Europe to begin to think about energy matters in security terms.

19. The EU has never managed to construct a common energy policy and every member state preserves its own national approach. The EU is deregulating markets and has thus ceded some of the tools it might have used to exercise a greater degree of control. Piotr Naimski questioned whether it was possible to deregulate one side of the market when the supply side is effectively monopolized.

20. Russia is now exploiting this state of affairs, and its own recent paper on Energy Policy to the year 2020 states on page 71 that the export of raw materials should be used as a political tool. In this respect, Russia's actions with regard to Ukraine and Georgia should not come as a surprise.

21. Hungary represents what some interpret as an extreme case of energy vulnerability. Russia provides virtually all of Hungary's gas, and Gazprom has been making a bid for a range of German-owned downstream assets that would effectively give Gazprom control of Hungary's entire gas chain. This is happening without very much discussion in the EU, NATO or in Hungary for that matter and it is worrisome. Brussels considers this a Hungarian matter and will not take it up. There are rumours that a similar process may be underway in Bulgaria. This raises important questions about the relationship between economic investment patterns, energy security and national security.

22. Poland is looking to build an intergovernmental mechanism to react to these threats. NATO should be part of this process. Indeed, if NATO is to play a part in responding to natural disasters, it makes sense that it also respond to an energy supply cut off. Cooperation is needed to ensure solidarity, supply diversification, market integration, redundant pipeline systems, and crisis management coordination. Of course, diversification is understood very differently between Madrid and Warsaw. Spain would welcome more gas from Russia while Poland would like to import more from Algeria. Building more links in the European system would help make this market relatively more seamless. Doing so also makes economic sense and it would encourage more price competition while lowering costs.

23. China's activism on global energy markets is also a concern. China is purchasing an enormous range of energy assets, storage facilities, oil and gas fields, tankers. It recently purchased 73 gas tankers in Qatar each weighing 250 tons. This is a huge fleet and it points to the kind of market power China increasingly demands. Moreover President Putin is increasingly playing a China energy card and making it evident to Europe that it now must compete with China for Russia's attention and for its gas.

24. As a result of its rising vulnerability, the West needs to invest as much as it can in alternative fuel technologies including clean coal, biomass, bioethanol etc. Ultimately it needs to move away from hydrocarbon dependence. This is not going to happen in the near term but efforts must now begin to diversify energy use and energy supply. Nuclear energy will also have to be part of the mix although Poland itself has a strong interest in developing clean coal solutions.

25. Polish energy is cheaper than in Germany but it lacks connections to the German market. But these links need to be forged for strategic and economic reasons. Price differences between countries are creating friction over deregulation but deregulation within Europe can have positive security effects, as it will lead to network redundancies.

26. Andrez Kryspin Babuchowski, the Secretary of State in the Ministry of Agriculture and Rural Development spoke on EU CAP reform. He outlined the details of Polish support for recent CAP reforms but also laid out what he defined as the limits of Polish willingness to move away from an interventionist agriculture policy. He argued that the EU should base its agricultural policy on competitiveness, stability and high quality products but argued as well that the EU should maintain its preference system against competitors that are not using EU norms. The presentation triggered a strong reaction from several members who felt that it was a defence of a highly protectionist system that penalizes developing country producers and imposes high costs on European consumers. Poland, however, is hardly alone in Europe in defending these elements of the CAP system and has become allied with countries like Spain and France in defending certain principles.

27. Witold Waszczykowski, Undersecretary of State in the Ministry of Foreign Affairs, next spoke about Poland's position as an EU and NATO member state. He argued that Poland accords great importance to its relations both with the EU and the United States. The government sees no contradiction between the two and works to ensure that the European project does not undermine the transatlantic partnership. Poland has supported NATO's transformation as a necessary adjustment to a changing world. For this reason, the Riga summit will be very important to solidify the new outlook of the Alliance. Poland wants NATO to develop its expeditionary dimensions but in such a way as to ensure that Article 5 of the treaty can be fulfilled. Thus Poland wants to retain a balance between expeditionary and territorial features of the military structure. Poland hopes that NATO will be able to formulate a new strategic concept by 2009, which would also be an appropriate year for future enlargement.

28. At the same time, the EU's own role in security matters is growing and it confronts many of the same threats and challenges that NATO must deal with including the proliferation of weapons of mass destruction, terrorism and the dictatorship in Belarus. The problem is that the two organizations often seem to be engaged in an unnecessary rivalry. Poland wants a strategic partnership to emerge between these two organizations and categorically rejects the notion that they should ever work at cross-purposes. It is particularly concerned about how some in the EU seem to welcome a rivalry. Poland has always resisted the notion that there is a choice between a good European and a good partner to the United States. Poland sees no dichotomy. There is no substitute for NATO in security terms and so a dialogue between NATO and the EU is essential so that Europe does not develop the notion that the EU needs to be a counterweight to the United States. Unfortunately the relationship is stagnating right now and it should be reinvigorated. There are many areas for potential cooperation on a range of practical military and diplomatic matters. The nuclear stand off with Iran is the latest crisis that might be better managed if NATO and the EU were to coordinate their approaches. These types of situations should not be allowed to divide the alliance.

29. Reform of NATO and the NATO-EU relationship should not take place in a vacuum. It should occur within the broad template of global changes that are shaping the foreign policies of allied countries. Thus NATO-UN relations are also a factor that must be considered. NATO must also be careful not to overreach, and Poland does not yet see a reason for NATO to focus too much attention on China.

30. NATO should remain engaged with Russia but it must be weary of what Russia is trying to do through its partnership. It seeks to change NATO without taking responsibilities for it. It wants to help set the NATO agenda without meeting NATO's own standards in a range of areas. The speaker also suggested that NATO does have a role to play in energy security matters. The Russians have openly admitted that energy should be used as a political tool and NATO members should not let themselves be held hostage to Russia. For this reason, NATO member governments need to build security arrangements to deal with any prospective supply crisis. These cannot only be market based. This presentation led to an exchange with the Chairman of the Sub-committee, Kurt Bodewig, over the question of whether Poland was itself not adopting a Euro-sceptical position.
