

AN OVERVIEW. OF EAST MED AND THE SITUATION IN UKRAINE

IENE SOFIA 19 MARCH CONFERENCE

The Chinese when they curse an enemy they wish him to live in "interesting times".

Well we can say that in SouthEastern Europe and the Mediterranean the past decade was very interesting!

1./In this brief tour d' orizon of the situation in our area we will briefly examine the situation from the Geopolitical,Economic and Energy points of view so that we all have at the end of the day an understanding of the whole area and some ideas on how events are likely to evolve from now on.

We will examine anti clock wise the Countries Libya,Egypt,Israel,Syria,Turkey and Ukraine. We will not examine the members of the E. U Cyprus,Greece ,Bulgaria,and Romania because the situation in these Countries will be discussed throughout the conference and also that the main problem of those Countries which is the Economic Crisis is very well known.

2./Two were the diplomatic milestones in the area in 2013.The multinational conferences in Syria and the understanding produced there and the very important breaking of the ice between the USA and Iran and the beginning of a rapprochement between those two Countries leading to a normalization of the relations of Iran and the West. The above are not going to evolve in a straight line. Already difficulties are reemerging in Syria and the pace of the improvement of relations between Iran and the West will only be as much as the Theocratic Government of Iran can afford which will define the speed of further negotiations. In this we are optimisti

3./Libya

The current situation is precarious . The interim Government extended its mandate in spite of the anger of the people. Two weeks ago protesters stormed the Libyan Parliament building. Two lawmakers were shot dead and many wounded. The parliament (National Congress) is split in two, Islamists and Revolutionaries essentially the Muslim Brotherhood versus Liberals and Nationalists.

The voting for the Constitutional Assembly which would provide Libya with a Constitution is characteristic of the alienation of the electorate with a turnout of only 12% of those entitled to vote.

NATO is in contact with the Government of Libya for assistance in security and Defence issues advice although it does not desire a full time presence on the Ground. This can be interpreted as an intention of NATO to discourage other external forces to be involved in Defence and Security issues in Libya.

The UN Security Council report of March 2014 highlights the deterioration of Security and the fragility of the Political Transition Process. For the moment it avoids recommendations of Sanctions against militias and other destabilizing forces.

Libya can face economic collapse in 2014 unless an understanding between the militias, labour unions and regional tribes can be achieved and this is not obvious on the Horizon at this time.

4./the Libyan Economy has only one asset, Oil. This asset collapsed in 2013. From 1,4mbd at the beginning of the year, oil exports dropped to 0,3mbd at the end of the year and at certain days even less at 0,1mbd. The net result was that the Libyan Government, to avoid the economic collapse in 2013, they used a significant part of their foreign currency reserves then standing at 120 billions of dollars. In fact they used about 20 billions but it is reported that starting from the summer 2013 the Government uses 7 billion dollars a month to cover the lack of income.

On top of the above there are clear separatist tendencies from the Eastern part of the Country with the so called Cyrenaica political Bureau that controls now the flow of the ex Government oil fields and are forming their own export companies. Events have reached such a state that the Prime Minister threatens to bomb tankers loading in "seceded " eastern terminals.

5./If a political settlement that is hoped for can be reached, there is no reason that oil export will not rise sharply and save the Economy as it happened in 2012. If a political settlement cannot be achieved then the Country will suffer a major economic collapse in spite of the foreign reserves that will not last for ever.

6./To us the bigger danger for the Country lies in the centrifugal tendencies developed in the East where most of the Oil is and the danger of non-democratic solutions. One thing is certain, the present mix of militias, labor unions and tribes must find common ground, otherwise the very existence of the Country is doubtful.

Egypt

7./Egypt is the key Country of the area, the stability and prosperity of which are very significant for the whole of the Middle East. The country is going through a difficult transition time. The important event is the Presidential election in April with the very probable candidature of the strong man of the Regime Field Marshal Al Siri but the new Presidential administration will face enormous challenges even if the Country quiets down which is uncertain. In spite of the Army's crack down on the Muslim Brotherhood adherents there is continuous low level insurgency in the Sinai peninsula sometimes apparent even in Cairo. Although the Brotherhood was far from being accepted by most Egyptians it has a significant and fanatic following that not only will not die down but will express its views in an increasingly violent mode.

8./The Economy is a major problem. In spite of the Government's effort for economic stability and the very significant subsidies with a fiscal stimulus package of many billion dollars given

by the Gulf States, the State run Economy is not performing satisfactorily having a double digit inflation, a deficit now of 14% of GDP and the debt reaching new records.. Tourism Income is down and only Suez Canal tolls and remittances from Egyptian workers abroad are doing well.

9./The Country is subsidizing heavily Energy and Food to the tune of 1/3 of all public expenditure. Subsidies of Energy alone stand at 16 billion dollars and half again of that are food subsidies. Although food is subsidized for 70% of the population only 30% really needs it with the result that subsidies are not enough for the part of the population that really needs it and malnutrition and big poverty exist particularly to the rural poor. Whereas all agree that the present form of subsidies is inefficient, any effort to rationalize and therefore reduce it for some parts of the population will result in turmoil. The fuel subsidies should be addressed first but it is doubtful if the new administration will have the public support necessary to proceed.

10./The challenges of the new Administration require a redirection of the Economy on a more viable economic path, the addressing of the big youth unemployment and the relief of poverty. All these need a calm political and social environment to succeed.

11./Regarding Energy it is necessary to remind that Egypt is the sixth largest Oil producer in Africa in Oil reserves, half of them off shore and the third largest Natural Gas reserves in Africa and also significant shale deposits. The present Government realizing that it is the major under developed asset of the Egyptian Economy is planning on auctioning 22 oil and gas concessions up to May this year. Egypt has already concluded in December last year deals with BP, Sinopec, Danagas Emirati and Petroceltic International so this activity is thriving in spite of the political troubles. Egypt is also normalizing its significant external Energy debts of 6,3 billion dollars by paying an initial amount of 1,5 billion to be followed by monthly installments over a long period of time.

This will improve Egypt's standing in the international Energy community. Still the internal need for Natural Gas reduces the exportable quantities affecting the payments issue. There is even an on going discussion for Egypt to import Natural Gas to be produced in the recent find in Cyprus. In any case the future of Energy and Energy investments is closely linked also with the level of political turmoil.

2014 will be a difficult transition time for Egypt. If the political unrest is reduced allowing the Army to stand back and a Civilian Administration to take over with only low level unrest then the problems ahead are difficult but manageable.

Syria

12./There is no end in sight for this bloody Civil War that now enters its third year. "Failure is staring me at the face" said Brahimi after the no result talks on Syria between Russian and US representatives in middle February

This war that reminds of the Spanish Civil War in the sense that it is not only internal but also a war by proxy is unlikely to end soon unless drastic political action is undertaken in concert

by both USA and Russia so that all the other smaller Nations and religious groups that are involved in one way or another will accept or be forced to step down. The Assad regime is surviving not only because of Iranian support and Hezbollah fighters but also because the numerous minorities of Syria feel safer under the more tolerant Ba'ath regime than under the new War Lords

13./The enormous humanitarian crisis with 140000 dead so far and millions of displaced persons continues with no end in sight of the bloodiest chapter of the Arab Spring with a level of brutality unknown even in Afghanistan. The independent Islamic groups such as Jabhat al Nusra or the more extreme one ISIS (Islamic State of Irak and Syria are not under any control other than the financial aid they receive from Gulf States, which now is practically stopped. Mainly their leaders act as independent local War Lords and their number is such that no coherent negotiation can take place. The in fighting between themselves is only to define their areas of influence and not any deep ideological differences. The Al Caida group emerges with both a political and a military open presence that bears no relation to the previous secretive terrorist group. It must be noted that the Gulf States have stopped the financing of Al Caida except Qatar which is being punished by the other Arab states. The Government forces are also indifferent to humanitarian disasters as a consequence of their fight against the above mentioned groups.

Insert map from front line

14./There is no end insight. Experts express opinions that predict that the war will last all this decade. The basic conflict now is between the Russia backed Shia and Alawite alliance of Iran-Syria-Hezbollah and the "Global" Sunni jihad of Gulf financed groups that are difficult to control as they do not agree even between themselves with for example the Al Caida leaders accusing the ISIS leaders .What is interesting to note is that Saudi Arabia and Koweit are distancing themselves from the conflict prohibiting to their nationals to participate in the conflict .

15./ The question at present is not if Assad will survive but rather if he will retake control of the whole country. However the opposing groups claim they can and will wait until Assad collapses after fighting continuously for years. What is certain is that new violent forces of considerable dimensions will emerge from this conflict.

Israel

16./2014 will be a milestone year for Israel. The principal issue of course is the Israeli-Palestinian negotiations which have reached the point of no return in our opinion. Before addressing this main issue we should mention the effort of Israel to improve its foreign relations with the Countries in the area. First is Turkey. Negotiations are practically concluded for the reestablishment of normal relations. Israel is going to pay a compensation of 8 million Euros to the families of the victims of Mavi Marmara and Turkey is to stop judiciary proceedings against those allegedly responsible. Normal diplomatic relations and Airline travel are all covered in the normalization agreement and an increase in commercial

activities can be foreseen. Interesting from our point of view are the discussions for the creation of a gas pipeline that will transport Israeli gas to Turkey and hence to the Turkish Hub. Israel will proceed in our opinion with an opening of diplomatic relations with Iran in the not too distant future now that Iran is in the process of normalizing its relations with the West.

17./the principal preoccupation of Israel with Syria is the estimate that this war will continue for years. This has as a result the growth of two tactical potential threats. The Hezbollah now fighting in Syria and not engaging Israel will emerge with a battle hardened Army that will be more difficult to deal with in a potential future Israeli-South Lebanon conflict where the last one was already very tough for Israel. The second is the emergence of the Al Caida as a formalized opponent now acting in a large scale in Syria with bases there and possibly also on Turkish ground and developing into an Army. This can potentially become a source of problems for Israeli Security. It is estimated that Israel will expect as part of the normalization deal with Turkey the containment of Al Caida activities there which is also a Western position and which should not be difficult in view of the very low tolerance for Al Caida activities that Turkey has.

18./Having stated this we should also note that the two major strategic threats for Israeli Security are in the way of being eliminated . Those are the Chemical Weapons stockpile of Assad and the Nuclear weapons development of Iran. On the conclusion of both agreements Israel will feel much safer.

19./The Principal issue of this year for Israel are the negotiations for the creation of a Palestinian State. The dynamic is very positive both in the United States and in Europe. Secretary Kerry, following the promise of Prime Minister Netanyahu to President Obama in 2009 that he would consent to the creation of a Palestinian State, is pushing aggressively for it and so are about 150 Israeli-American organization and so is the European Union and a significant section of the Israeli Public. Any positive decision for this will mean a cost for Israel, be it the Israeli settlements in the West Bank, concessions in Jerusalem and many others. The Israeli Government that will accept the necessary compromise for the successful conclusion of the negotiations will face important internal political cost and severe criticism from various political dissenters and important vested interest in the status quo as it always happens in similar situations. The Palestinians under Abbas having sensed this are at present very accommodating and Hamas which has lost Egyptian support does not make excessive noise. If the Israeli Government withdraws from the negotiations it will face enormous diplomatic and peer pressures from East and West. If the Government concludes successfully the negotiations it will face enormous criticism and strong reactions inside Israel. The Government of Israel cannot easily afford either.

Turkey

20./Turkey at present faces four problems:

The Economic Crisis

The Political unrest

The Corruption investigations

The Syrian issue

However these can be classed as tactical problems because events in 2013 are working in a Strategically beneficial way for Turkey . The situation in Ukraine is upgrading the importance of Turkey both within NATO and also diplomatically as a major factor in the Black Sea that enjoys good working relations with both Russia and the West. The normalization of relations between Iran and the West creates the possibility of Natural Gas exports from Iran to the West through Turkey making possibly TANAP a trunk pipeline carrying both Azeri and Iranian gas with the further possibility of Turkmen Gas either by land pipeline through Iran or by underwater pipeline a project that has already been studied and is easily feasible technically.

The normalization of relations with Israel further to the commercial improvements presents the possibility of Israel channeling its Natural Gas through Turkey.

The successful conclusion of the Greek Cypriot-Turkish Cypriot talks will have as a result the channeling of the Cypriot Natural Gas through Turkey

If one adds the present Blue stream and Azeri gas already flowing westwards it is obvious that Turkey will become the HUB for Gas in the whole area and will to a considerable extent satisfy the increasing needs of the EU for Gas in addition to the Gas provided by Russia.

Taking under consideration that Caspian Oil and Iraki Kurdistan Oil are already flowing in the port of Cheyhan it is obvious that Turkey is emerging as "The" Major Energy Distributor in the Area.

21./Addressing the problems of Turkey,the simpler one is the Economic Crisis. This is only partially Turkey's fault because all the emerging economies are collapsing as a result of the US tapering by the Fed because the dollars return to the Center from the Periphery and it is expected that the Turkish Currency to devalue along with the Rupee,the Rand ,the Peso and other currencies. A bit more worrying for Turkey is the deficit now standing at 7,5% of GDP and inflation that is approaching 8%. But Turkey has a very low public debt of about 40% of GDP. The points of worry for the Turkish Economy are mainly two: The fact that 2/5 of the debt of Turkish Companies is in foreign exchange and also a principal source of investment are Saudi Arabia and the Gulf Emirates. Difficulties in borrowing and liquidity problems may result in the collapse of the building sector which has already bubble characteristics anyway. A significantly increased unemployment will result and some Companies and the Banking sector are also bound to suffer.

It must however be stressed that cyclical problems of this type are not unknown in Turkey and that the Turkish Economy ,which is a vibrant one,will rebound with vigor ,the long term economic prospects of Turkey are very positive.

22./The internal political unrest is a phenomenon that occurs in all countries at times of economic difficulties but we believe that neither the challenge to the AKP will succeed nor the corruption accusations will affect greatly the voting public since they both appear to be politically motivated by a non parliamentary entity. With the opening to the Kurdish minority the Turkish Government will increase its acceptance in the Kurdish areas and we expect AKP to be the winner of the March elections and Turkey to have a stable Government

23./The common frontier with Syria is creating problems for Turkey both for the reception and support of big numbers of Syrian refugees and also the need for increased resource allocation in the patrolling and protection of the common frontier to avoid violent events and activities on the Turkish side.

The active involvement of Turkey in the events in Syria is giving not only problems but also significant diplomatic clout to Turkey as most assistance to the anti Government forces in Syria goes through Turkey. This makes Turkey a significant player in any future Syrian settlement

Turkey will have to reposition itself on the Syrian question in view of the changing posture of the Gulf States on the issue

Ukraine

24./The short and medium term expectations for this Country are bleak and no one can risk to make a long term forecast on its future .

For the West it is the last bastion of the ex Soviet Union,for Russia it is the Front Porch of their House and for Ukraine is the dramatic split of the Country

25./The present problem is the culmination of 23 years of mismanagement ,neglect of the homogenization of the Country and oligarchic kleptocracies operating with western or eastern facades.

26./Since the events of Feb 22 destroyed the agreement reached for a Government that covered both Eastern and Western interests and replaced it with the present pro Timoshenko and pro Right Sector Government supported by oligarchs provoked pro Russian protests in Crimea and Eastern Ukraine against the Kiev government. This mainly because the Russian government considers the Kiev regime as a threat to its security. The exclusion of Klishko also marginalized Germany and thus EU and the Challenge became mainly a US-Russian one.

27./The events then took a well known military flavor. The very smooth and easy take over of Crimea shows extensive planning and preparation as well as the acceptance of this by the majority of the population.

As things stand today the cessation of Crimea can be considered as irreversible . The military and political value of the Peninsula for the Russians is such that they are willing to pay high costs for its de facto and/or de jure ownership of this land.

28./The East -West split of Ukraine has reached such a stage that the existence of Ukraine as a unified Country is threatened and is developing towards a Bosnian model or worse

The contest is much more important to Russia than the USA but the confrontation costs are also higher for the Russians.

Russians with their dogma of "near abroad" will not tolerate a Ukraine associated with the EU and the Western Defence Alliance that will bring NATO 150kms from Moscow .

They will encourage secession ,already under way for the whole of Ukraine east of the Dneipr and the Odessa region. It must be noted that Ukraine and the West have no significant capability or intention against Russia.

Equally the Western Ukrainians,part of the West in the past and Catholics to the Greek Orthodox Eastern Ukrainians will not accept any Russian influence in thei Country as they see in the EU their only chance of political and economic salvation.

29./Whatever happens in the political sector the Country is bankrupt. The West alone cannot afford the cost of its economic rehabilitation.

For this to be achieved a Troika of EU ,IMF and Russia must be created,provided that the Country remains somehow united and also that the oligarchs will moderate their take from the Economy.

If the West manages to produce a more palatable to the Russians Government,with early elections and a new Administration covering all tendencies, Ukraine may remain united and solvent.

30./The most important issue for this Conference is the future of the energy pipelines supplying gas to the West. The same pipelines that supply gas to Western Europe supply also gas to the Ukraine . Ukraine is unable to pay for gas to Gazprom and is already overdue for tho billion dollars in spite of the preferential rate that now is also likely to be abolished.Ukraine imports more than 30 bcm yearly fro Russia, that covers 60% of its needs. Alexander Medvedev, the export boss of Gazprom stated that they will stop gas deliveries to Ukraine only by Government order

As we know from the past any stoppage of the supply of Ukraine with gas will automatically also stop the supply to Western Europe of 80% of Russian gas. This will strongly affect Romania ,Bulgaria and Greece.

It is obvious that the supply of Western Europe with natural gas must be both reconsidered and recalculated.

Intervention by H.E Dr. Petar Poptchev:

"The situation in and around Ukraine is dynamic and volatile. It is difficult to predict how the issue of a potential gas crisis could evolve. Commenting on the state of affairs in the first ten days of March, and based on reliable open sources, the Oxford Institute of Energy Studies in

particular, Gazprom seems to have conveyed the following messages: first, there is no particular ground to expect interruption or cessation of gas deliveries through Ukraine because Gazprom had prepaid its taxes for use of the Ukrainian transit system Europe until 2015, second, Naftogas Ukrayni owes Gazprom just under \$ 2 bln. (a manageable debt), third, the level of volumes in European storage facilities is satisfactory and the continent is coming out of a mild winter.

In 2013 Gazprom transited 86 bcm of natural gas through Ukraine to Europe (53% of all deliveries) at an average price of \$387 per 1000 cm. This amounts to a total annual revenue of more than \$ 33 bln. from the Ukrainian direction, a sum that is not negligible to a cash-stripped Gazprom.

For the sake of Gazprom shareholders a worst-case scenario was played (interruption of all Russian gas deliveries to Europe through Ukraine). The options are: 55 bcm through Nord Stream, 33 bcm through Yamal-Europe and 16 bcm through Blue Stream. This summation is mostly theoretical (because deliveries to the end consumers cannot necessarily be ensured through these three corridors) but even if it were physically viable Europe would still expect about 51 bcm of Russian natural gas through Ukraine - for the simple reason that 155 bcma have already been contracted by Gazprom and European importers for 2014. (155 minus 104). Presumably, Russia would like to put these 51 bcm through South Stream and forget about the Ukrainian transit gas system for good. However, even if South Stream were to be completed in time with a capacity of 63 bcma, its total effect would not be realized before 2018 - 2020 at the earliest.

The bottom line then is that the EU (and Russia for that matter) would be "stuck" with the need for the Ukrainian transit system for the next 5-6 years at least. Constructive approaches to this lasting situation will therefore have to be discussed and applied".