
A storm is brewing in the East despite temporary gas truce.

By EBR Staff Writer
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The January 2006 Russia-Ukraine gas deal has been temporarily extended to the autumn; a temporary truce largely driven by Russia's position as chair of the G8. There are two events on the horizon with potentially serious implications for the reliability of gas supplies to Europe: Yulia Tymoshenko's appointment as Ukrainian prime minister, and Turkmenistan's decision to hike gas prices to Russia.

'Content Last year, Russia sparked a crisis in European gas supply by seeking to unilaterally end a long-term gas contract with Ukraine and raise prices to international levels. In November 2005 Russia proposed a price rise from \$50 per 1,000 cubic meters to \$160, but the following month it suddenly raised the price to international levels (around \$230 per 1,000 cubic meters). This was twice the amount paid by Armenia, Georgia and the Baltic states, and much more than the existing \$50 special rate effectively reserved for pro-Russia former satellites such as Belarus.

AdvertisementRather than phase-in price increases or go to international arbitration as requested by Ukraine, state-controlled Gazprom said it would simply turn gas supplies off on January 1, 2006, if Ukraine did not comply. Ukraine did not comply and continued to take gas out of transit pipelines pursuant to its original agreement, bringing accusations of theft from Gazprom.

Some 80% of Europe's Russian gas is transported across Ukraine, and when the taps did get turned off, seven European countries reported 30% drops in gas pressure within hours.

Russia under pressure

These events were bizarrely timed by Russia to coincide with its chairmanship of the G8, with a specific focus on energy security. The EU ratcheted up diplomatic pressure for the dispute to be resolved and, immediately after the US weighed in, a deal was reached on January 4, 2006. This was accomplished by blending much cheaper Turkmen gas with Russian gas, to produce an overall price to Ukraine of \$95 per 1,000 cubic meters.

Gas prices under this new contract were scheduled to come up for review on July 1. Up to the day before the deadline Russia had not decided whether it would raise rates or not. At the same time Ukraine's outspoken former prime minister Yulia Tymoshenko has been waiting in the wings, making dramatic declarations about the need to scrap the contract altogether. The brewing storm has been averted at the last minute through an agreement between the departing administration in Kiev and Moscow: the terms of the January agreement are to be extended to the end of Q3 2006.

There can be little doubt that the 'energy security' G8 meeting in St. Petersburg on July 15, at which Russia is the chair, is the driving factor by this sudden capitulation by Russia and Gazprom.

This new agreement, however, is a truce and not a resolution of the dispute. The task of setting in place a long term agreement remains unresolved. To this end, two interwoven variables could yet combine

to create potentially serious disruptions in future gas supplies to Europe.

The Tymoshenko factor

First, Ukraine's former firebrand prime minister Yulia Tymoshenko is on the cusp of re-forming a government, and she has already called for a revision of the Russia-Ukraine gas contract. The January compromise gas deal was only possible because Ms Tymoshenko had earlier been replaced as Ukraine's premier. During and after this spring's national elections, she repeatedly called for the January gas deal to be called off.

The returning Ms Tymoshenko is dedicated to forcing RosUkrEnergo out of the Ukraine-Russia pact. In 2004, in the dying days of former president Leonid Kuchma's government, this murky company secured a sweetheart intermediary role carrying Gazprom-secured gas from central Asia to Ukraine, through Gazprom pipelines, to sell on to Ukraine's NaftoGaz Ukrayiny.

The commercial rationale for RosUkrEnergo's role is unclear. But the company's original involvement as monopoly gas supplier to Ukraine was set up under President Kuchma's pro-Russia, pre-Orange Revolution government, just before it orchestrated massive electoral fraud in a bid to hold on to power through presidential candidate Victor Yanukovich. The company is consequently seen by many, and most importantly Yulia Tymoshenko, as a vestige of that regime. This has direct implications for the security of gas supplies to western Europe.

Turkmenistan turns tables

Ironically, Russia is now in the position that Ukraine was last year.

Turkmenistan, having learned from Russia's hard ball strategy, has stated that it wants to raise the price at which it sells its gas to RosUkrEnergo (from \$65 per 1,000 cubic meters to \$100), otherwise it will cut off supplies. It threatens to do this by September, at which point the current 30bcm supply contract with Gazprom is expected to be fulfilled.

Negotiations with Gazprom have recently broken down, and a Ukrainian delegation immediately began talks to negotiate a new deal. Such a deal would reduce Ukraine's dependence on Russian gas and break Gazprom's monopoly on central Asian gas (though Ukraine will nevertheless have to use Russian pipelines to transport the gas).

This unresolved dispute threatens to intensify in the near future, with serious consequences to secure gas delivery through Russia and Ukraine to Europe.

The saving grace in all this potential turmoil is Russia's chairmanship of the St Petersburg G8 summit on July 15. Russia's desire to calm tensions and prove itself a responsible energy leader is driving its current stance.

And so, notwithstanding the focus of the current G8 summit, the next few months will see feuds over the structure and price of major gas contracts escalate, with potentially serious ramifications on the security of gas supply.
