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RUSSIA – UKRAINE RELATIONS AND GAS POLITICS WITH THE EUROPEAN UNION

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Summary

Till recently, nothing much was heard about gas politics between Russia and Ukraine as both countries were one. After the disintegration of the former Soviet Union, the new order and quest for economic benefits and political importance, especially in Europe, has drawn the two countries into confrontation which has adversely affected their relations. Gas conflict between the two countries, and subsequently, European Union has been occurring, almost on yearly basis. This article traces relations between Ukraine and Russia and analyzes how Russian gas and its transit to Europe has affected relations between the two countries. The work also reviews present effort at restoring smooth gas business between the stakeholders.

Key Words: Russia, Ukraine, European Union, Gas, Relations.

Introduction

Historically, Russia and Ukraine share a lot in common and their relations could be dated to far period of Kievan Rus; a predecessor of both Russian and Ukraine nations. Kiev in a modern capital of Ukraine and is often referred to as a mother of Russian cities or cradle of Rus civilization. Both Rus and Kiev nations have ever been united until the invasion by the Mongols which brought division between them. The Rus then successfully united with its remnant kinsmen in the northern provinces and grew into a powerful Russian state while Kiev came under the dominion of Poland but the increasing pressure of Poland, the Zaporozhian Cossacks as they were then referred to, sort union with Russia in the Treaty of Pereyaslav. By the 18^{th} century, Ukraine was finally absorbed into the Russian Empire with inclusion of portions of Poland. Ukraine was then called little Russia and there was a close relationships between the two nations. After the October Revolution, Ukraine became a battleground in the Russian Civil war and both Russians and Ukrainians fought in nearly all armies based on their political belief.

When the Union of Soviet Socialist Republics was formed in 1922, both Russia and Ukraine were founding members and when the union was disintegrated in December 1991, they were equally signatories of the treaty that terminated it. Diplomatic relations between the Russian Federation and Ukraine were established in 1991 immediately after the dissolution of the Soviet Union, of which both were founding constituent republics. Presently, Russia has an embassy in Kiev and consulates in Kharkiv, Lviv, Odessa and Simferopol. Ukraine also has embassy in Rostov-on-Don, Saint Petersburg, Tyumen and Vladivostok. With the disintegration of the Soviet Union, a lot of serious disputes and issues that deserves urgent resolution arose. The first was the question of the Crimea, which the Ukrainian Soviet Socialist Republic had administered since 1954. It was resolved with Russia allowing Crimea to remain part of Ukraine, provided that its autonomous republic status is allowed to exist.

The other burning issue was the control of the Black Sea Fleet located in Sevastopol, a city that was directly subordinate to Moscow. Ukraine had laid claim to the fleet because it is located in its land, and Russia strongly felt that the fleet was one of her assets inherited from the former Soviet Union. After several years of intense negotiations, it was resolved that Russia retained its base in Sevastopol until 2017.

Areas ans Issues of Conflict in Russia-Ukraine Relation

Another of the unresolved issues was the energy supply problems as several Soviet – Western Europe oil and gas pipelines run through Ukraine. Russia had severally accused Ukraine of siphoning off its gas enroute to some European countries. According to Wikipedia, in the 1990s, Ukraine openly siphoned off Russian gas, and after new treaties came into effect, the enormous debts were paid off by transfer of several Soviet weaponry and nuclear arsenals that Ukraine inherited to Russia such as the Tu-160 bombers. From then till date, there have been accusation and counter accusations between the two countries not only on the gas issues but other events that have threatened the good relations existing between the two countries. Worthy of note was the accidental shooting down of a Siberia Airlines, Tupolev Tu-154- in 2002 by the Ukrainian air defence. Russia accused Ukraine of acting in bad fate while Ukraine vehemently denied this insisting that it was a mere accident.

The Orange Revolution of 2004 was another issue that affected Russia – Ukraine relations. In a keenly contested presidential election in 2004, Russia had supported the candidature of Victor Yanukovich, who represented the Eastern, pro-Russian industrial labourers while the US and the European Union backed Viktor Yushchenko, who had been nursing the ambition of leading Ukrainians to escape Russia’s shadow and join the rest of Europe and the West. In the end, the courts favoured Yushchenko and he was consequently inaugurated as the new president of a unified Ukraine.

Ukraine’s desire to join the European Union and North Atlantic Treaty Organization (NATO) was another burning issue in relations between the two countries. Russia has viewed Ukrainian’s membership of NATO as its total withdrawal from Russia’s orbit. This move was seen as change of course to only a pro-Western, anti-Russian orientation of Ukraine and thus a sign of hostility and this resulted in a drop of Ukraine’s perception in Russia (although Ukrainian President, Yushchenko reassured Russia that joining NATO is not meant as an anti-Russian act). Therefore, when Ukraine and Georgia were denied membership of the NATO Membership Action Plan (at the NATO summit April 2008), Russia's NATO envoy, Dimity Rogozin STATED in December 2008 that they will not invite these bankrupt scandalous regimes to join NATO… more so as important partnerships with Russian are at stake, after an earlier statement that in the broad sense of the word, there is a real threat of the collapse of the Ukrainian state" (Wikipedia). In reply to this, continued Wikipedia, Ukrainian envoy to NATO Ihor Sahach said: "in my opinion, he is merely used as one of cogs in the informational war waged against Ukraine. Sooner or later, I think, it should be stopped".

The envoy did not stop at this but further expressed a surprise with Rogozin's slang words. According to him; "it was for the first time that I heard such a higher official as envoy using this, I even don't know how to describe, whether it was a slang or language of criminal circles … I can understand Russian language, but, I am sorry, I don't know what did his words mean". (Wikipedia).

It could be recalled that relations between the two countries deteriorated during the 2008 South Ossetia war over the new rules for the Russian Black Sea Fleet to obtain permission when crossing the Ukrainian border, which Russia refused to comply with. During that war, the Russian Prime Minister, Vladimir Putin accused Ukraine of supplying arms to Gesrgia. He claimed Moscow had evidence proving that Ukrainian military experts were present in the conflict zone during the war. Ukraine denied the allegation and pointed out that the head of its state arms export company, Ukraspets export said that no arms were sold during the war, and Defense Minister, Yuriy Yekhanuvov denied that Ukraine's military personnel fought on the side of Georgia.

In all these disputes, the one that has affected relations between the few former leading republics of the former Soviet Union is dispute about national gas prices supplies of Russian natural gas through Ukraine to other parts of Europe. In 2004, Russian oil giant, Gazprom exported around 150 billion cubic meters of gas to 22 European countries. In a Europe of 35 countries, Russian gas accounted for nearly 40% of total imports and 28% of gas demand in that year. (Gazprom in figures 2004). All Russian gas exports to Europe (except deliveries to Finland and the portion of Turkish exports delivered via the Blue Stream pipeline) transit through three countries: Ukraine, Belarus and Moldova. Ukraine holds the pivotal geographical position with more than 80% of Russian gas exports to Europe delivered via that country in 2004· (Trends and Figures 2004).

It could be recalled that shortly after the disintegration of the Soviet Union and subsequent formation of the Commonwealth of Independent States (CIS) in 1991, the Ukrainian – Russian relationship was characterized by Ukrainian inability to pay for up to 50 bcm yearly which it imported from Russia, leading to very high levels of debts and unpaid bills, which subsequently led to reduction of Russian gas supplies to Ukraine for short periods of time, aimed t restoring payment discipline. This in turn led to unauthorized diversion of the volumes in transit to European countries. In 2004, the Russian government, Gazprom and the Ukrainian government agreed the arrangements for delivery Central Asian (mostly Turkmen) gas to Ukraine and settlement of past debts were agreed. Gazprom was to loan money to the Ukrainian gas company Naftogaz to enable it pay past gas debts, and to provide an agreed foundation for at least five years deliveries of Turkmen gas and transit of Russian gas in Europe. This agreement foresaid deliveries of Russian gas to Ukraine of 21 – 25 bcm per year for the period 2005 – 09, as a barter payment for transit of gas to Gazpron's European customers. For this barter agreement – under which no actual money changed hands between the parties – the national price of Russian gas sold to Ukraine was $50/mcm and the national tariff for transit of Russian gas across Ukraine was $1.09375/mcm/00km. (Stern 2006).

The 2005 Gas Crisis

With this agreement sealed, it seemed that the required elements for regularizing Russian – Ukrainian – Turkmen gas trade were in place for the next 5 – 10 years. This was shortly proven wrong as another gas supply crisis erupted between the two countries in 2005. The dramatic political development in Kiev in December 2004 saw the election of Yushchenko as President of Ukraine and the political wronging associated with his election brought new developments in relation to Ukrainian – Russian gas supplies. According to Ukrainskaya Pravda (2006), the crisis started over Turkmen gas supplies. In December 2004, the Turkmen authorities requested a price increase from Russia and Ukraine from $42/mcm to $60/mcm for 2005. By the end of December, Turkmen gas flows were abruptly halted which necessitated rapid negotiation, between Ukraine and Turkmenistan allowing flows to restart to Ukraine on January 3, 2005 at a price of $58/mcm (50:50 cash/barter). (Interfax Oil and Gas Report 2004). In January 2005, the new joint venture RosUkrEnergo became the shipper of Turkmen gas, a role which had previously been carried out by Eural Transgas and earlier Itera. According to Stern (2006), deliveries to Russia did not resume until May 2005 after negotiations between Turkmen President, Niyazov and Gazprom Chairman, Miller established that the price of $44/mcm would remain for 2005 – 2006 but would be 100% cash rather than 50/50 cash/barter. From July 2005, Ukraine also opted to pay a cash price of $44/mcm bringing it into line with Gazprom. But shortly after, a new problem emerged; Turkmenneftegaz signed a new contract with Naftogaz Ukraine for 50 – 60 bcm/year for the period 2006 – 26, with the Ukrainian side to decide on the shipper of the gas. Russia’s Gazprom was excluded in this new deal. However, in October 2005, Turkmen President, Niyazov insisted that any long term gas arrangements with Ukraine must need to involve Russia.

Central Asia Energy Monthly (2005) notes that the centre of the conflict was that it was revealed in May 2005 that 7.8 bcm of gas which Gazprom deposited in Ukrainian storage reservoirs during the previous winter had not been made available to the company despite 40 requests sent between October 14, 2004 and March 22, 2005. A version of report on the mystery surrounding the missing deposit suggested that the gas had disappeared (due to technical problems) or had been stolen by unknown persons. Gazprom was unwilling to accept any of the explanations and insisted that the volumes would be subtracted from transit payments to Ukraine which would have meant – given the volumes which had already been delivered in 2005 – that Ukraine would have received virtually no additional gas during the remainder of 2005. (Stern 2006). In reaction to this, according to Interfax Oil and Gas Report (2005), Ukraine said that in the event of such action, gas in transit to Europe would be taken to make up the shortfall. And, because Gazprom could not afford to falter in exporting gas to Europe suggested that Ukraine should pay European export prices, which would have amounted to $600 million. Solution to the face-off was eventually found when both countries agreed to two-stage payments of the volume thus; that 2.55bcm of gas as repayment of Gazprom’s transit liabilities and, 2.25 bcm of gas to be delivered to RosUkrEnergo during 2005 – 2006. (Stern 2006).

This arrangement was a far-cry of the required lasting solution to the problem of prices and transit tariffs between the two countries. Apparently, hoping that it would be to the advantage of Ukraine, Yushchenko Administration in March/April 2005 suggested that gas transit should be moved to “European” levels and paid in dollars. Russia was fast to accept the proposal and in July 2005, the Russian Duma (in response to a request from the Prime Minister) voted unanimously that CIS countries – Georgia, Moldova, Ukraine, Estonia Latvia and Lithuania – should pay “world” (i.e. European) prices for gas.

The January 2006 Crisis

By January 1, 2006, tension between Russia and Ukraine was high, with both countries accusing one another of insincerity. Gazprom accused Ukrainian man companies of diverting gas from transit pipelines meant for European countries. Ukrainian companies, on the other hand were accusing Gazprom of pumping insufficient gas into those pipelines. In any direction the pendulum swung, the European countries that were expecting gas from Russia were badly hit. The fall in volume delivered to European Union countries caused an outery all over Europe. By January 2, Hungary was reported to have lost up to 40% of its Russian supplies. Australian, Slovakian and Romanian supplies were said to be down by one third, France 25 – 30%, and Poland by 14%. Italy reported having lost 32million cubic meters, around 25% of deliveries, during January 1 – 3. (Stern 2006). German deliveries were also affected but no specifics were given. On January 2, Gazprom reacted by saying that it would pump an additional 95 million cubic meters per day into the network to compensate for Ukrainian withdrawals. (Interfax Oil and Gas Report (2005). By January 3 and 4, Russian gas deliveries to Europe were back to normal. The dispute lasted for 4 days after which Gazprom and Neftogaz announced an end to the dispute with signing of a 5 year contract with the following terms: -

- Gazprom will pay Naftogaz a tarrif of $1.60/mcm/200km for transit of gas to Europe.

- RosUkrEnergo will be the company which delivers gas to Ukraine. Gazprom will not deliver Russian gas to Ukraine, and Naftogaz will not export any gas which it has received from Russia.

- RosUkrEnergo and Naftogaz will form a joint venture by February 1, 2006 in order to market gas in Ukraine which has been received via the territory of the Russian Federation.

- RosUkrEnergo's annual gas balance will consist of:-

· 41 bcm of Turkmen gas purchased form Gazexport and RosUkrEnergo;

· Up to 7bcm of Uzbek gas purchased from Gazexport with the specific aim of swaps with deliveries to Caucasus countries.

· Up to 8bcm of Kazakh gas purchased from Gazexport with the specific aim of swamps with deliveries to Caucasus countries;

· Up to 17 bcm of Russian gas purchased from Gazprom with a base price of $230/mcm. (RIA Novosti 2006).

The agreement was signed on February 4, 2006 by the three parties: Gazprom (A. B. Miller), Naftogaz (A. G. Ivchenko), RosukrEnergo (O.A.Palchikov and K. A. Chuichenko).

The bulk of the commentary in the European press endorsed Ukrainian President, Yushcheuko's position that this ways a politically motivated dispute in which the Russian side was attempting to blackmail Ukraine Politically by placing it under extreme economic pressure. (BBC News Website 2006)

The January 2009 Crisis

The Russian energy giant, Gazprom suspended gas deliveries to Ukraine on January 1, 2009 over non-payments and the two sides' failure to agree a delivery contract for 2009. A week later, Gazprom accused Ukraine of stealing gas intended for European consumers and cut off gas supplies to the European Union via the country, prompting two weeks of major gas shortages across Eastern Europe.

The BBC News Website notes that the cut off of Russian gas to Europe led to difficulties for a number of countries. Slovakia announced that it was ready to reactivate one of the reactors at the atomic energy station; Yaslovsk – Bogunits, but then abandoned the idea. Bulgaria demanded compensation from Russia for halting supply in the sum of approximately $250 million, and the Public Gas Corporation of Greece (DEPA) demanded $1 billion.

As a result of this, discussion was started over alternative source of energy supply to Europe. The proposition of the Nabucco project, which proposes the transportation of gas from central Asia and the Capsian region by circumventing Russia gained more attention. The project, however, is embedded with many difficulties. The main and practically unresolved problem of the Nabucco project is the shortage of gas; Azerbaijan and Turkmenistan have insufficient capacity, since they can guarantee no more than 3 billion cubic meters of gas per year, yet the launch of the project requires no les than 15 billion. Iran can supply the shortfall, but US sanctions impede this.

The Europeans feel that one more obstacle is the position of Turkey, which wants to receive for its own needs 15 per cent of the calculated 30 billion annual volume of gas moved along the pipeline… (Stern 2006). With Turkey having close military ties to NATO and the US, and with her wanting to become a member of the EU, which was denied not long ago, many don't see any difference between her and Ukraine if a situation is created where Turkey is sitting on gas transit.

Agreement was, however, signed on January 19, 2009 in Moscow between the Prime Ministers of Ukraine and Russia, Yulia Timoshenko and Vladimir Putin and supply of Russian gas to Europe was renewed. Many observers still entertain fears that lasting solution has not been finally found and Bremmer argues that the agreement on gas supplies, that finally emerged will not create a foundation for longer-term improvement in Russia – Ukrainian relations. It won't be long before Russia and Ukraine are at it again over energy supplies or something else.

The Implications of the Agreement

The political implication of the agreement is evident in the rancour and squabbles between the Ukrianian Prime President, Viktor Yushchenko and Prime Minister, Yulia Timoshenko, and by extension, strained relationship with Russia. Having become Prime Minister of Ukraine in December 2007, Timoshenko has repeatedly insisted on removing the intermediary RosUkrEnergo (RUE), a Swiss – based gas trader owned by Russian gas giant Gazprom and two Ukrainian businessmen, from the system of gas supply, something that has now been done. The Prime Minister has accused Amitry Firtash, the businessman who controls the Ukrainian side of RosUKrEnergo of Involving in "dirty deals" under the protection of Yushchenko, his very close friend. She further threatened to name politicians and bureaucrats who are mired in corruption and who are advocating, according to her, an escalation of the natural gas conflict with Russia.

On his own side, President Yushchenko accused Prime Minister Timoshenko of betraying national interest in agreement she signed with Putin-Medvedev government in Moscow on January 19, 2009. Although he was forced to reconcile himself with the agreement later, he called it a "clear loss" for Ukraine.

Prior to this, both leaders have shared different opinions on fundamental issues affecting Russia – Ukraine relations. Timoshenko represents the interest of those layers of the Ukrainian ruling elite who, while not renouncing the strategic goals of the pro-Western "Orange Revolution" of 2004, would like to avoid antagonizing the Kremlin and find areas of compromise between the two regimes. Again, unlike Yushchenko, Timoshenko in not striving for the country to become a member of NATO at any cost, nor does she support the efforts of the president to encourage anti-Russian moods.

On the economic implications of the agreement, questions and doubts have been raised and expressed on the ability of Ukraine to pay for the higher gas prices Russia is now charging. Under the supply contract signed, Ukraine will pay the European market price with a discount rate of 20 per cent. This brings the gas price for Ukraine to $360 per 1,000 cubic meters in the first quarter of 2009. The price will be changed every quarter and reach the full European market level from January 1, 2010. According to Ukrainian calculations, the price for the second quarter should be $270/cm for the third $219, and for the forth $162. (Volkov 2006). Under the transit contract, Gazprom will pay Ukraine the discounted transit fee of $1.70 for transporting 1,000 cubic metres for 100km. From January 1, 2010, the transit fee will reach market level and will be calculated according to a general European formula.

To put it succinctly, Volkov says that Ukraine has nothing with which to pay for Russian gas, especially at prices that are close to European levels. According to calculations of the Russian weekly Smart Money, given an approximate price of $250 for 1,000 cubic metres, the Ukrainian yearly spending on natural gas will reach $13.7 billion, which exceeds a third of the revenues of the country's budget for 2009 ($31 billion). He notes that on the side of Russia, the direct losses for Gazprom due to the halting of natural gas through Ukrainian territory are estimated to be $1.5 billion to $2 billion.

Conclusion

It is generally argued that the main motive behind Moscow's readiness to increase tension is a desire to achieve maximum profit from export of energy resources, as well as to use economic levers to guarantee more advantageous geopolitical positions, and that the increases had arisen without warning. The truth is that the crisis had, in fact, been brewing for much of 2005 and arguably, for several years previously. Russia has, however, maintained that Gazprom's contractual obligation is to ensure that full flows of gas are maintained to EU countries. Failure to meet that obligation will call into question the security of Russian gas supplies. Again, any cuts in Russian gas supplies to CIS (let alone EU) countries will be interpreted in Europe and the US as being politically motivated, irrespective of the cause of the reduction and the strength of evidence showing political motivation. It is, however, not obvious that following these events, European companies and governments will hurry to make alternative multi-billion dollar investments in energy supply infrastructure projects requiring 5 – 15 years lead times, with uncertain commercial outcomes.

Russia believes that the only lasting available solution to the gas crisis is to politically force Ukraine to fall in line by sticking to agreements signed by her. The role of the European Union here is very obvious. It has to insist that Ukraine does not divert gas meant for the Union. The membership issues of Ukraine into the EU must be determined not based on oil politics but strict adherence to basic requirements and other vital considerations stipulated by the Union. Ukraine must also be made to realize that Russia did not envisage crisis when the decision of running the pipelines through the country was made, even though, it was done before the disintegration of the Soviet Union.

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