Analysis

Background to the Russia-Ukrainian Gas Crisis: Clarifying Central Issues and Concepts

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Media accounts and the statements of interested parties often use such terms as "Ukraine's stealing of gas," "Russian's subsidization of Ukraine," and "Gazprom's move to market prices." Often these phrases hinder an accurate understanding of the issues at stake. Thus, it is worth taking a second look at some of these issues and how they play out in today's conflict.

The Debt Issue

Ukraine's debt to Gazprom and other suppliers has been a recurring problem in the relationship since Ukraine's independence in 1991, a problem complicated by issues of state responsibility for private debts, non-repayment of previously restructured debt, and accusations of illegal re-exports and the unsanctioned siphoning of gas. If on the technical side the absence of gas metering stations on Ukrainian territory (all metering stations for incoming gas are located on Russian territory) made it difficult to establish the exact volumes of gas pumped into the Ukrainian pipeline network, lack of transparency and the politicization of the issue have made the situation even more murky. With the debt issue a good cover for corrupt deals, few of the involved actors have been interested in fully clarifying the situation. While Russia and Gazprom have complained loudly about Ukraine's accumulated debt since the early 1990s, such debt provided Russia with a kind of "rain-check" it could make use of when necessary, to be exchanged for political or economic concessions – as it did in 1997 when it persuaded Ukraine to give up most of the Black Sea Fleet in exchange for gas debt forgiveness.

On the Ukrainian side, murky debts played an important role in the system of widespread energy corruption. During Yulia Tymoshenko's tenure as first vice PM in charge of energy, she used the debt issue in her confrontation with rival Ukrainian energy groups, surprisingly announcing that Naftogaz debt to Gazprom actually amounted to over $2 billion, while Naftogaz's management cited a figure much closer to $1 bn. The same story repeated itself in October 2007 as the Rada elections that were to return Yulia Tymoshenko as prime minister were about to take place, and again during the March 2008 "mini-crisis" over the question of who the gas in Ukraine's underground gas storage belongs to. Such differences in debt numbers were especially significant, as each of the Ukrainian rival groups had its own system of connections in Gazprom, which would also be affected by the size of the officially-recognized debt – an "unclear numbers game" clearly benefited top managers at both NAK and Gazprom, as it made it easier to carry out and cover corrupt operations.

In addition, the term "Ukraine's debt to *Gazprom*" does not accurately reflect the situation at the end of 2008, as by definition Naftogaz Ukrainy could not have a debt vis-à-vis Gazprom, as in 2008 the company did not have direct contracts with Gazprom, only with RosUkrEnergo (50 percent of which is owned by Gazprom).

The "Gas Stealing" Issue

Much of Gazprom's media campaign to weaken Ukraine's transit reputation has been based on presenting Ukraine as an unreliable transit partner, and, in particular, on accusations of Ukrainian stealing of Gazprom gas intended for export. Such accusations were a staple of Ukrainian-Russian relations throughout the 1990s and early 2000s. Yet there are many indications that the stealing was not carried out unilaterally by the Ukrainian side. Rather, it can be seen as an example of the confluence of interests between specific actors on the Ukrainian (NAK Naftohaz Ukrainy and its predecessor, Ukrhazprom) and Russian sides (Gazprom). [1]

1 Ukraine's top energy experts, as well as a number of Kuchma-era politicians, have been largely unanimous in confirming the existence of this type of arrangements. See for example Oleksandr Moroz (leader of Ukraine's Socialist Party) quoted in *Gaz i neft´. Energeticheskii biulleten´*, February 13, 2002 (via ISI), Volodymyr Saprykin, interview in Radio Svoboda Ukrainian service "Priamyi Efir," April 12, 2005 17:00 UTC, text available at www.radiosvoboda.org/article/2005/04/69d7a9c5-6fdb-489e-9075 c4ed57a3c7bb9.html (accessed April 14, 2005), Dmytro Vydrin (Director, European Institute of Integration and Development, Kyiv) quoted in "Gazovyi kontsortsium. Otsenki ekspertov," *Gaz i neft´. Energeticheskii biulleten´*, July 16, 2002 (via ISI), Dmytro Vydrin, interview in *Nezavisimaia Gazeta*, November 16, 2000, p. 5, and Yevhen Marchuk, interview in *The Day*, No. 32, November 7, 2000, available at www.day.kiev.ua/266656/ (accessed July 30, 2007).

The Notion of "Market Prices"

Russian commentators have repeatedly used the concept of "market prices" in both the 2006 and the 2009 confrontations, arguing that Russian demands for higher prices for its gas are simply a manifestation of a positive general trend in Gazprom gas pricing policy towards market policies and away from the politicization of energy relations. Gazprom has repeatedly argued it will charge Ukraine "market prices," presented as either "average European prices" or "German prices minus transport costs." Leaving aside the fact that in the course of the confrontation with Ukraine the prices Gazprom quoted and demanded changed repeatedly, "market" gas prices are very hard to determine given the absence of a single worldwide gas market similar to that existing in the case of oil; moreover, the confidentiality of commercial contracts with European importers makes it very hard to clearly establish the average prices. The time lag involved in conventional gas pricing formulas makes things especially complicated at a time of sharp fluctuations in oil prices, on which such formulas are loosely based: while in most EU cases prices are adjusted monthly and thus can adapt, albeit with a lag, to changing oil prices, in the case of Ukraine, prices are set once a year covering the whole year, making the oil quotation at the time of the initial negotiations especially crucial.

Moreover, if we understand "market prices" as prices arising from the meeting of competitive supply and demand, we can easily see that this condition does not obtain in Russian-Ukrainian gas trade, as Ukraine is faced with a single monopoly supplier. Finally, despite all the talk about moving to "market" gas prices across the board, Gazprom continues to set gas prices politically, as can be seen by broad differences in prices charged to post-Soviet states in 2008: from $110/mcm charged Armenia and Belarus, to $278.71 for Moldova.

The "Subsidization" Issue

As the confrontation escalated, Russian PM Putin presented the accusation that, in the last years, Russia had "subsidized" Ukraine to the amount of $47bn, mainly in the form of lower-than market prices for gas. This effective sound-bite, however, does not reflect the complexity of Ukrainian-Russian relations since 1991, which make it extremely hard to calculate any such "subsidization." The first problem is that much of the gas trade until 1997 took place on the basis of barter, making it extremely easy to manipulate effective prices through barter coefficients and transactions involving multiple exchange rates. Moreover, a full picture of any subsidization would not be complete without a consideration of Ukrainian services provided to Russia, in particular its de facto subsidization of Russian gas exports to Western Europe. This has taken place through transit and underground gas storage prices much lower than those prevalent in EU countries. Cheap access to gas storage has been especially important for Gazprom, as it has allowed the company to "park" its gas in Ukraine, to be sold to EU users at peak demand periods for higher prices.