try and will have, at least to a certain degree, to develop a nation-building doctrine of his own.

Conclusion—A Serious Need For New Ideas

Yanukovich has already announced that he will stand for a new, pragmatic and more balanced foreign policy. This approach will especially include rebuilding the Ukraine-Russia relationship. Will it also mean the reopening of former Ukrainian president Kuchma's "multi-vector foreign policy" or just a slightly more pro-Russian course? The analysis here demonstrates that the change from Yushchenko to Yanukovich should not be overrated and that an evaluation of the structural preconditions for a rapprochement between both states leaves a rather ambivalent picture. Thus, Yanukovich's alleged pro-Russian outlook will not only be tempered by his now being the leader of the Ukrainian nation, but also by his foremost task to secure the very stability of Ukraine as a polity in severe crisis. Last but not least, the lack of sophisticated concepts and structures in the Ukrainian-Russian relationship beyond the "Friendship Treaty" and some gas agreements is puzzling and seems to be a major obstacle for further progress. Especially on the Russian side, one cannot shake the impression that no one really wants a well defined concept vis-á-vis Ukraine since such a comprehensive policy is viewed as an obstacle to the Kremlin's policy of neo-imperial reflexes.

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Analysis

Ukrainian-Russian Gas Relations After the 2009 Conflict: The Current Situation and Future Prospects

By Katerina Malygina, Bremen

Abstract

The gas war in January 2009 led to a reexamination of the contracts between Ukraine and Russia for delivering and transiting gas. Additionally, the election of Ukraine's new president means there will be changes in the energy dialogue between the two countries. The new realities demand an analysis of the status quo and the possibilities for change in Ukrainian-Russian gas relations.

Consequences of the Gas Contracts for Russia

One of the most important consequences of the 2009 gas war was the elimination of the intermediary-company RusUkrEnergo (RUE) in the gas trade between Russia and Ukraine. Ultimately, Russia likely profited more than Ukraine, even though Ukraine initiated this process. First, in 2009 Russia paid for gas transit across Ukrainian territory through barter, reassigning to Ukraine RUE's $1.7 billion in debts to Gazprom. Second, Russia revised its contract with Poland on terms that were favorable to it. Thus, after the elimination of the intermediary RUE, Poland did not receive the gas that it had contracted from it and began negotiations with Gazprom about purchasing additional gas. The nearly year-long negotiations with Poland resulted in the signing of an inter-governmental agreement which defined the terms of gas deliveries through 2037. In addition to the long-term contract, Gazprom also achieved confirmation of the principle of unanimity in management decisions regarding Europolgaz, the joint venture between Gazprom and the Polish oil and gas company PGNIG. The changes which Gazprom had aspired to since 2006 deprived Poland of its previous priority in setting tariffs on transporting gas across the Polish part of the Yamal gas pipeline.

Gazprom's success in signing the gas contracts with Ukraine in January 2009 allowed it to partially compensate for its reduced income from European sales in the 2009 crisis year at the expense of Ukraine. Overall income from Russian gas sales abroad in 2009 compared to 2008 dropped 40 percent and totaled $39.4

billion, according to Russian Federal Customs Service data. Gazprom received one-fifth of its income ($8 billion) from sales to Ukraine. Accordingly, it was important to Russia that Ukraine paid for its gas in full. During the course of 2009, Russia's leaders never tired of repeating one and the same message to their Western partners – Ukrainian difficulties in paying for Russian gas could lead to the revival of problems transiting gas across Ukrainian territory. The public relations campaign by Gazprom sought to achieve two goals. First, it reinforced Ukraine's image as an unreliable transit country and thereby increased support for the alternative Nord Stream and South Stream pipelines. Second, it deflected European attention from Gazprom's financial problems and simultaneously forced the EU and IMF to offer financial support to Ukraine to pay for its gas.

The actions of Prime Minister Vladimir Putin demonstrate Gazprom's persistence in attracting foreign investors to guarantee Ukraine's timely payments for gas. In the beginning of June 2009, just as a scandal broke out about the need to fill Ukraine's underground gas storage depositories, Putin called European Commission President Jose Manuel Barroso and requested a $5 billion credit for Ukraine. After his request was refused, Putin made a similar plea to the IMF. This time Russia suggested Ukraine pay its gas bill by using the IMF special drawing rights that the G20 had created at its 2 April 2009 summit. These rights were distributed in August. Ultimately Ukraine used its share to pay for Russian gas in Fall 2009. Thus without the active support of Russia, Ukraine might have missed a payment for gas, which would have led to another crisis in the two countries' gas relations.

Another consequence of the 2009 gas conflict was Russia's increased activity to diversify its gas pipelines around Ukraine by building the Nord Stream and South Stream pipelines. Russia's success in this regard is obvious: in February 2010 Gazprom received all the permissions it needed to build Nord Stream. In 2009, South Stream also received much greater international support – now Gazprom has signed agreement for the foreign land-based pipelines with Bulgaria, Serbia, Hungary, Greece, and Slovenia. Also Turkey is expected to give permission to build the South Stream pipelines in its waters by November 2010. However, the money set aside by Gazprom in its 2010 investment program for building these two pipelines is only $4.65 billion, which would probably be enough to lay the first part of Nord Stream, which Gazprom hopes to begin using in 2011. Additionally, in February 2010, Russia postponed the exploitation of the Shtokman site for three years until 2016–2017, which should send gas to Europe through the Nord Stream pipeline. A major factor in Gazprom's plans is the "quiet revolution" in the production of shale gas in the US, which has already led to the redirection of Qatar's LNG from North America to Europe, thus becoming a catalyst in reducing gas prices in the EU. Accordingly, despite Gazprom's rhetoric, realization of the South Stream project will also likely be postponed.

From the perspective of advancing its gas interests during the 2009 crisis year, Russia was generally successful. Nevertheless, the 23 March 2009 Brussels Declaration issued by the international donors' conference on modernizing Ukraine's Gas Transport System (GTS) weakened the position of the Russian side. According to this Declaration, Ukraine will take responsibility for reforming its gas transportation system, using credits from European banks. However, from the Russian perspective, any modernization of the system without first consulting Russia, the supplier of the gas, would be irrational. Therefore Russia insists on a tripartite modernization of the Ukrainian GTS. Additionally, the Declaration allows the European companies to buy gas not at the border of the EU, but at the border with Russia, a provision that significantly reduces Gazprom's influence in Ukraine and Europe. Naturally, Gazprom protested sharply against the Declaration and its delegation even abandoned the negotiations. Later, in November 2009 Ukraine played the "Brussels card" to win gas contract concessions from Russia.

Consequences of the Gas Contracts for Ukraine

The main event in Ukrainian politics during 2009 was the monthly intrigue about the country's payment for gas. Despite the tough rules for paying for natural gas (no later than the 7th of each month, otherwise fees would be levied) and the difficult economic situation in the country, Ukraine nevertheless paid on time for Russian gas. It helped that Prime Minister Yulia Tymoshenko took a personal interest in this matter: with the presidential elections approaching at the beginning of 2010, it was extremely important for her to create a myth about Ukraine's ability to pay and to hide the unprofitability of the gas contracts signed with her support.

In order to meet Ukraine's obligations to Russia, the prime minister used non-market methods. Payments for gas were made mainly on the basis of credits from state banks: in 2009 Ukraine's overall state debt grew to 112 billion grivnas (about $14 billion), of which a half (56.8 billion grivnas) went to providing financial aid to Naftogas Ukraine. To pay for Russian gas, the Ukrainian government used other contrivances as well: reimbursement of the value added tax (VAT) to Naftogaz Ukraine (8 billion grivna at a time when the government owed enterprises 25 billion in VAT refunds), monetizing the special drawing rights received from the IMF in August 2009 (approximately $2 billion) and since the beginning of 2010, with the IMF's permission, deploying the country's hard currency reserves (up to $2 billion).

Such payment schemes were necessary due to Naftogaz's poor financial health. In Fall 2009, Naftogaz only with great difficulty succeeded in restructuring its debts: in particular, the company could not pay its Eurobond for $500 million and instead paid only interest on it. By 1 October 2009, Naftogaz's debt reached 42.58 billion grivnas (about $5.3 billion). The overall sum of court claims against Naftogaz on 5 November 2009, was 38 billion grivnas (about $4.75 billion). Additionally, in the middle of November Rosukrenergo quadrupled – to $8.26 billion – its claims against Naftogaz for expropriating 11 billion cubic meters of gas during the winter of 2009.

Fundamentally addressing Ukraine's inability to pay for its gas over the long term is impossible without cardinal reforms in Naftogaz. The government's effort to improve the state of the gas company by transferring management of its gas distribution system to a subsidiary company Naftogazseti, created especially for this purpose in June 2009, seems to be very ineffective. Until June 2009 regional distribution companies (oblgazs) controlled the gas distribution network and provided gas to the final customer. Unfortunately the distribution companies did not pay Gazprom for all the gas that they consumed: the general debt of the regional gas companies for 1999–2008 on 1 January 2009 was 6.7 billion grivnas (about $850 million at the current exchange rate). On the eve of the presidential elections, the government refused to take more radical steps, such as increasing gas prices for the population to the market level, despite the IMF and European banks' advice to do so. At the same time, the Ukrainian government set aside 7.7 grivnas ($1 billion) in budget funds to subsidize the difference between prices for purchasing imported gas and selling it to public organizations and the population.

The consequences of the new gas contracts and Tymoshko's gas policy will be felt for a long time. The excessively high prices for natural gas made Ukraine's main export items – metals and chemical products – uncompetitive. The average price for natural gas paid by chemical enterprises in Ukraine using natural gas as a basic input in June 2009 was $318 for a thousand cubic meters, which was three times more than in the European Union and five times more than in Russia, according to European Union of the Chemical Industry data.

In this context, President Viktor Yanukovich's announcement calling for a re-examination of the gas agreements with Russia in order to establish a "just" price for gas seems entirely logical. However, Yanukovich's proposals seeking to interest Russia in such a step raised a storm of protest in Ukraine, including accusations that he had sold out the country's national interests. In particular, Yanukovich offered to return to the 2002 idea of creating an international gas transportation consortium. The task of the consortium would be not only using the existing Ukrainian gas transportation system, but also modernizing it with the participation of Russia, while at the same time increasing the flow of transit gas to Europe to 200 billion cubic meters. Shares in the consortium would be divided among the EU, Russia, and Ukraine evenly (33.3%). According to Yanukovich's plan, Russia should forego its plans to build pipelines around Ukraine. Gazprom is prepared to examine the proposals about the consortium, but does not plan to revisit its decisions to build the Nord Stream and South Stream pipelines. The danger for Ukraine in creating such a consortium is that Gazprom could own more than 60 percent of the shares if Gazprom-affiliated energy companies participate from the European side.

Failure to Observe Contracts

Almost immediately after Ukraine and Russia signed the new contracts in 2009, both sides began to violate their conditions. Ukraine did not fully take its contracted level of gas, while Russia decided not to impose the financial sanctions provided for in the contract.

Officially, the evolving practices were codified only toward the end of the year. On 24 November 2009 Gazprom and Naftogaz signed an addenda to the 19 January 2009 contract on buying and selling gas. According to the new agreement, Ukraine reduced the level of its imports from Russia in 2009 from the initially envisioned 40 billion cubic meters to 33.51 bcm and in 2010 from 52 bcm to 33.75 bcm. Since the actual imports in 2009 were 27 bcm, Naftogaz formally met the norm in which it had to purchase 80 percent of the natural gas that it had contracted to buy. The new agreement also omitted fines for Naftogaz's failure to purchase the contracted levels of gas in 2009. These fines would have amounted to $8 billion. The contracts signed at the end of November did not violate the original contract since it foresaw the possibility of changing the amount of gas. Nevertheless, according to the contract, the revised sum should have been signed into place six months before the beginning of the year of delivery, ie no later than July.

The two sides are also not observing all the conditions in the second contract on the transit of Russian gas across the territory of Ukraine. According to the contract, payment should be made only in money. However, in the winter of 2009 Naftogaz accepted former gas trader RosUkrEnergo's debt to Gazprom for approximately $1.7 billion (or 11 bcm of gas) in exchange for Gazprom's payments for transit. In April 2009 Ukraine almost agreed to purchase $5 billion worth of gas to fill its underground gas storage facilities in exchange for future transit services. For several reasons, the deal did not take place: instead of 19–20 bcm Ukraine could only buy 0.8 bcm.

Thus, the new gas contracts between Russia and Ukraine, like the previous ones, are highly conditional and their implementation is selective. Moreover, the new contracts did not eliminate the old barter system of trading gas for transit. If this practice is adopted for the long term, as Tymoshenko and Putin sought to do in April 2009, it would make the formula approach to calculating the cost of transit almost inoperable. Finally, the addenda to the January 2009 agreement signed in November 2009 covers only 2009–2010. Thus, questions about addressing the existing problems after 2010 remain on the agenda.

Outlook

Russia's further cooperation with Ukraine in the gas sphere will be built in accordance with the principles laid out in Russia's new energy strategy through 2030, which was adopted on 13 November 2009. Among the goals this strategy identifies are "reducing the risk of transiting Russian energy to the export market," which directly affects Ukrainian-Russian gas relations. Russia has adopted a two-pronged strategy for meeting this goal.

First, Russia is actively attempting to put generally accepted transit rules in place for existing and new international legal documents. After the gas conflict with Ukraine, Russia withdrew its signature from the Energy Charter and in April 2009 launched an initiative to develop a new concept for energy cooperation which would unite all the main energy producer, transit, and consumer countries. This year it is highly likely that the Russians will succeed in this area: at the beginning of 2010 the EU's chief representative in Russia Fernando Valenzuela announced that the Energy Charter could be reexamined to take into account Russia's interests.

Second, Russia has not stopped searching for a way to use Ukraine's Gas Transit System (GTS) for its purposes. In the near future, a new intergovernmental agreement on cooperation in the gas sphere between Russia and Ukraine is to be signed. According to the Russian version of the agreement, Ukraine would have to waive any immunity it enjoys, regarding itself and its property, in the event of a dispute. The GTS is the property of the Ukrainian government but Ukrainian law currently forbids its privatization or bankrupting Naftogaz. And while the Russian version of the agreement likely will not be signed, after the recent change in Naftogaz's property status, Russia will have a little more leeway in carrying out its plans. Experts think that reorganizing the company from a state form of ownership to public ownership makes it possible to transfer the property of the gas concern in case it does not pay off its creditors.

Ukraine is seeking ways to increase its energy security and reduce its dependence on Russian gas supplies. First, it wants to increase its own gas production. If contracts are not rewritten and the price for gas remains high, Ukraine could resume exports of its own gas to Europe. Second, according to the Ukrainian Cabinet of Ministers, electricity production from renewable resources could allow the country to save up to 18.5 bcm of natural gas a year, reducing consumption in Ukraine by the end of 2010 by 13.5 percent. Third is increasing the energy efficiency of industrial enterprises. As a result of the crisis and high prices for gas, work in this direction accelerated in 2009, but the first results will only be felt this year. Finally, in connection with the increased supply on the markets of LNG and shale gas and the falling prices for these fuels, Ukraine is considering building a LNG regasification terminal with a capacity of 20–30 bcm. Gas received in this way, even taking into account transportation costs to the Ukrainian border, would be cheaper than Russian gas, the price for which is set in relation to the price of oil.

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Katerina Malygina is a doctoral student at the Research Centre for East European Studies at the University of Bremen and a freelance writer for the online-journal *Ukraine-Analysen*.

(recommended literature overleaf)

Recommended Literature:
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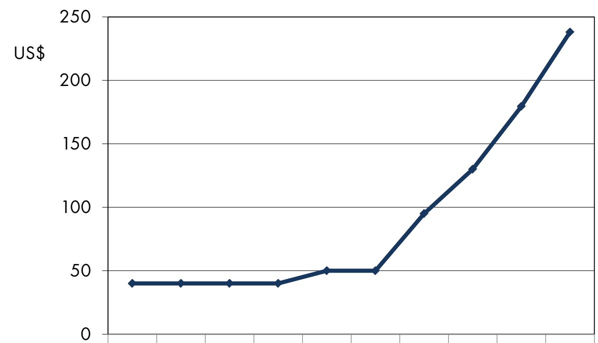
Statistics

The Russian-Ukrainian Gas Trade

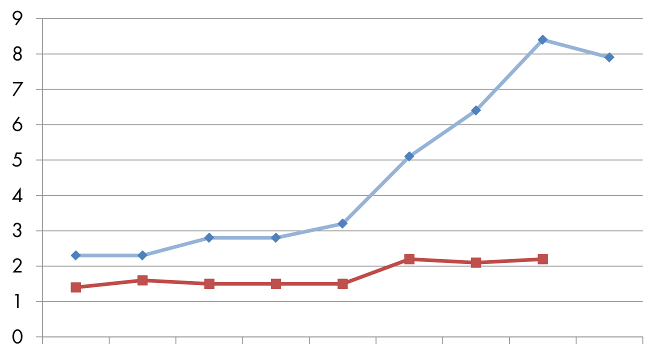
Diagram 1: Ukrainian Import Prices for Natural Gas 2000–2009 (US$/mcm)



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Ukrainian Import Prices	40	40	40	40	50	50	95	130	179.5	238

Sources: Institute for Economic Research and Policy Consulting, Kiew, http://ier.org.ua/papers_en/v12_en.pdf*, for 2001–2008: Katerina Malygina for 2009*

Diagram 2: Ukrainian Expenditure on Natural Gas Imports and Revenue from Natural Gas Transit (bn US$)



	2001	2002	2003	2004	2005	2006	2007	2008	2009
Expenditure	2.3	2.3	2.8	2.8	3.2	5.1	6.4	8.4	7.9
Revenue	1.4	1.6	1.5	1.5	1.5	2.2	2.1	2.2	n.a.

n.a. = not available
Source: Simon Pirani, Oxford Institute for Energy Studies, for 2001–2008; Katerina Malygina for 2009