The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

3rd 'Gas War' Looming Between Russia, Ukraine, EU

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August 13, 2014



Ukraine currently has enough gas to last until the New Year. What could follow in January was described by political pundit Pavel Salin as a “communal catastrophe” and a real threat to Ukraine's new leaders.

Weather forecasters promise 32 degrees Celsius in Kiev on Thursday — which makes the near-citywide absence of hot water due to a shortage of Russian gas more bearable.

But things could get much uglier in winter, when a "humanitarian catastrophe" looms, if the confrontation between Moscow and Kiev over Ukraine's rebellious eastern regions remains unresolved and Russia turns off the gas tap, analysts said.

While political pundits say the ongoing pro-Russian insurgency in Ukraine is Moscow's last remaining leverage against Kiev, the Kremlin still has a "gas truncheon" at its disposal. Ukraine is entirely dependent on Russian gas supplies, and half of Russia's gas exports to Europe flow through its pipelines.

The gas weapon is ineffective in the summer, but a new "gas war" between Russia and Ukraine — which would be the third so far — is waiting to happen this fall, when the energy- and cash-strapped Ukraine will have to provide for its citizens and factories, experts said.

The worst case scenario is a season-long halt to Russian gas supplies to Ukraine and the European Union, which, while not leaving populations to freeze, would ground Ukraine's industrial output and cause supply disruptions in the European countries beyond.

But Kiev and Brussels are more likely either to cut a new deal with Moscow — which would also suffer from the "gas war" through lost revenues — or just get gas elsewhere, though at a higher price, analysts said.

Turning Off the Tap

Technically, the third "gas war" kicked off in mid-June, when Russia stopped supplying gas to Ukraine over an unpaid bill for gas estimated by Russia's gas export monopoly Gazprom at $5.3 billion.

Russia continues to supply gas to the EU through Ukrainian pipelines. Europe bought about 160 billion cubic meters of Russian gas in 2013, according to Gazprom, providing for 35 percent of EU's total gas consumption, put by think tank Eurogas at 462 billion cubic meters.

Russia's relations with Ukraine and the EU are at a record low due to the pro-Russian insurgency in eastern Ukraine, which Brussels and the pro-Western government in Kiev see as the latest move in Moscow's years-long campaign to keep Ukraine from integrating with the West.

Manipulating gas prices has been the Kremlin's weapon of choice in this campaign — Moscow has briefly halted westbound gas supplies twice, in 2006 and 2009.

'Humanitarian Catastrophe'

The impact of closing the gas taps is limited in the summer, when gas consumption is low, energy and political analysts said. But the problem is a time bomb set to go off during the cold season, gas industry expert Rustam Tankayev said Wednesday.

Ukraine currently has enough gas to last until the New Year, said Tankayev, who works for the Russian Union of Oil and Gas Producers.

What could follow in January was described by political pundit Pavel Salin as a "communal catastrophe" and a real threat to Ukraine's new leaders.

"A lack of basic comforts for the population could seriously damage the legitimacy of the Ukrainian government," said Salin, who works at of the government-affiliated Financial University in Moscow.

Much depends on how severe this winter will be. "General Frost" has contributed to many Russian military victories, and may now help out again in an economic war.

"Weather forecaster is the most politically important job this year," Salin quipped.

Reverse Supplies

Ukraine is scrambling to save enough gas for the winter.

Some measures smack of either extravagance or desperation, such as the hot water shortage in Kiev.

The Ukrainian Cabinet also proposed last month that the national standard for the minimum room temperature in private residences be slashed to 16 degrees Celsius, a drop of 2 degrees.

A more reliable plan is reverse supplies from the EU, which can resell Russian gas to Ukraine, but the current capacity of reverse supplies is no more than 1.5 billion cubic meters of gas this year, Tankayev said.

Ukraine's current gas deficit for the upcoming heating season was estimated last month at about 6 billion cubic meters by the country's state-run gas company, Naftogaz.

EU countries are reluctant to increase the reverse supplies, both because they need gas for themselves and because they do not believe in Ukraine's ability to pay, Tankayev said.

Russian officials have said they expect Ukraine to start "syphoning off gas" — de-facto theft — when the cold season arrives, repeating its behavior during previous gas wars.

Ukraine is currently pushing to get the EU to buy Russian gas at the Russian-Ukrainian border, which would make reselling that gas to Kiev much easier. The EU has shown little enthusiasm for the idea, but has called for tripartite talks on gas between Moscow, Kiev and Brussels in early September.

Mutual Economic Deterrence

The actual medieval-style freezing of people in their homes is not on the cards for Ukraine, "General Frost" or no, experts agreed.

One option for Kiev is denying gas to industrial enterprises while using available gas for heating purposes, Tankayev said.

Another option is just buying up gas elsewhere — for example Norway. This would cost extra and decrease the quality of life in Ukraine and the EU, but solve the more pressing concern of keeping warm in winter, said Konstantin Sonin of Moscow's Higher School of Economics.

And in the meantime, Russia would be losing customers and money, on top of the ongoing threat of new Western sanctions, Sonin said.

Gazprom could lose up to $7 billion this year if the gas cut-off to Ukraine continues to the end of the year, news website Gazeta.ru said last month.

This mutual dependence between Russia and the buyers of its gas provides a form of economic deterrence not unlike the nuclear deterrence of the Cold War, only with economic losses

instead of a possible nuclear fallout to keep the parties from going overboard, said Slava Rabinovich, the founder of asset management firm Diamond Age Capital Advisors.

"Moscow will most likely solve the crisis by offering some sort of political package deal to Kiev and Brussels in the fall," said Salin of Financial University.

"They can just back down on gas in exchange for a land corridor to Crimea," he said. The Crimean peninsula, the annexation of which in March wrecked Russia's relations with Ukraine and the West, has no land connection to Russia.

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Original url:
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