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Success of Russia-Ukraine Gas Deal Depends on EU's Willingness to Pay

By Alexander Panin

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Ukrainian Energy Minister Yuriy Prodan speaking after talks in September between Russia, Ukraine and the EU.

As the Russian and Ukrainian Energy Ministers sit down with European Commission chaperones to resolve their intractable natural gas dispute on Tuesday, the ball will be in the EU's court, which is expected to finance both Ukraine's and its own energy security.

With the approach of winter sharpening the minds of negotiators, Russian President Vladimir Putin and his Ukrainian counterpart Petro Poroshenko reached a preliminary deal on Friday in Milan to renew gas deliveries to Ukraine that were cut in June over a dispute over pricing and multibillion-dollar debt repayments.

But it is unclear whether the agreement will stick, and still hazier whether it can answer Europe's energy security concerns. A situation similar to that which occurred in 2006 and 2009, when price disputes with Ukraine caused temporary supply disruptions to EU, could

well be repeated. Russia has already said that if Ukraine siphons gas destined for Europe out of pipelines passing through its territory, it would cut the same amount of gas to EU.

Give or Take $100

Supplies to Ukraine were cut off in June because Kiev balked at the $485 Russia demanded for each 1,000 cubic meters of gas — far over the $385 average paid in Europe and the $268 it had paid before Moscow-friendly President Viktor Yanukovych was ousted by protests in February.

In Milan, Russia softened its demands, agreeing to decrease its price through March next year by $100 to $385 and shave "a billion dollars" off what Russia says is Ukraine's $5.3 billion debt for previous gas deliveries. To sweeten the pill still further, Putin agreed to lower the amount of initial debt payment Ukraine must make before supplies resumed from $2 billion to $1.4 billion.

Poroshenko on Saturday welcomed the deal: "As the result of the talks I can say that Ukraine will be supplied with gas, Ukraine will be warm," he told television cameras in Kiev.

Russian Energy Minister Alexander Novak confirmed that the sides had agreed on all the main parameters of temporary winter gas supplies, including prepayment terms and the debt payment schedule.

But the question remains: even with the discounts, where will crisis-stricken Ukraine get the money to pay the debt and finance new supplies?

Putin, speaking at a news conference in Milan, called for the European Commission to lend a hand: Ukraine won't get Russian gas unless it prepays and Europe should extend loans or aid to help it do so, Bloomberg quoted him as saying.

Russia's Energy Ministry said in a statement on Friday that Ukraine, together with the European Commission, will have to provide $1.6 billion "in the form of loans or guarantees from first-class financial institutions" to finance the prepayment of gas supplies.

In an interview on national television on Sunday, Ukrainian Prime Minister Arseniy Yatsenyuk said Ukraine had $3.1 billion on its current account that could be used "for previous or future gas supplies." The sum is the exact amount of debt Ukraine has agreed to pay out to Russia before year's end.

But Poroshenko said Ukraine did not have enough cash to cover gas supplies and would have to turn to partners in EU for financial support.

"We have several options, ranging from International Monetary Fund finance to international financial organizations that could support the deficit of Naftogaz [Ukraine's state-owned energy company]," Poroshenko said in a TV interview.

Chance of Success

Konstantin Simonov, director of the National Energy Security fund, a Moscow-based consultancy firm, was skeptical that a final agreement could be reached on Tuesday.

"Three weeks ago [during the last gas talks in Berlin] Russia, EU and Ukraine had already agreed on the same terms of gas supplies as last week, only to have them later dismissed by [Energy Minister Yuriy] Prodan and Yatsenyuk as a misunderstanding," Simonov said, adding that on Tuesday the agreement could be destined for the same fate.

Following the last round of trilateral gas talks at the end of September, European Energy Commissioner Günther Oettinger said Ukraine has agreed to pay the gas debt of $3.1 billion by the end of the year. Russia then said it would resume gas supplies if Ukraine payed part of the debt. Prodan, however, dismissed the agreement, saying the money was meant as prepayment for gas supplies next year.

Judging by the contradictory statements made by top government officials, there is no unity among the Ukrainian elite, Simonov said, adding that disputes within the country could create even more obstacles for the gas deal than the lack of money.

However, Mikhail Korchemkin, director of U.S.-based consultancy East European Gas Analysis, expected the gas deal to be signed on Tuesday.

"But the deal will not ensure safe gas transit to Europe through Ukraine's territory. Moscow may still find a reason to close the valve shut," the analyst said.

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