GlobalResearch
Center for Research on Globalization

Natural Gas is What Detonated the Ukraine Crisis

By Andrew McKillop
Global Research, March 03, 2014
21st Century Wire

Region: Europe, Russia and FSU
Theme: Oil and Energy
In-depth Report: UKRAINE REPORT

This week the whole of the western media and geopolitical discourse reads 'Crisis in Ukraine', and the media juggernaut is quickly morphing into one of 'The West vs Russia'.

Few in the western media, much less the leading political mouths in Britain, Europe and the US, are willing to address what triggered this latest geopolitical 'crisis'. It's better to move the public along with the threat of war narrative (much better for news ratings).

Always Smoldering – Ukraine's Gas Debts to Russia

Defending Moscow's December 18, 2013 agreement to provide Ukraine with an aid package estimated at about $15 billion, and cheaper natural gas through discounts and "gas debt forgiveness" estimated as able to save Ukraine $7 bn in one year, Vladimir Putin said the decision to invest $15 bn in 'brotherly slavic' Ukraine, and grant the gas discount was "pragmatic and based on economic facts".

At the time, the "investment" in Ukraine was already conditional – not only on the political issue of Ukrainian loyalty to Moscow – but on Ukraine complying with previous longstanding, often revoked, modified or extended commitments to repay gas debts dating from as far back as the early 1990s. In December, Russia's Finance minister Anton Siluanov said payment of the "aid or investment" funds to Ukraine, in tranches of about $2 bn each, would need Ukraine making a serious response to end-2013 estimates, by Russia, of the minimum "monetized gas debt" Ukraine has to pay. Siluanov's ministry said this was about $2.7 bn, itself a large downward revision on other published figures from Russian sources, extending well above $5 bn. His ministry also published statements suggesting that Ukraine's non-payment of gas taken and consumed by the country, since 2010, ran at a yearly average as high as $2 – $2.25 bn.

To be sure, events starting in February as the "Maidan movement" drew massive public support in the capital and western Ukraine to overthrowing the government-in-place. This was a repeat of Egypt's anti-Morsi flash mob street revolution, followed by the Saudi-financed military coup against elected president Morsi. In Ukraine, however, the street magic stopped in the east, and especially in Crimea where 75%-85% of votes cast in the 2010 election were for Viktor Yanukovych.

To be sure, this blood-colored version of the Orange Revolution aimed at aligning Ukraine with the European Union may have scarpered further bail out payments by Moscow. Any upping of the ante, as enacted and supplied by NATO and John Kerry, could lead to Russia also making a total shutdown of gas supply to Ukraine – Kiev's Independence Square flash mob could hope that Global Warming will shorten the winter, ease heating needs, and give

Ukraine a head start for becoming a debt wracked European Union associated country – but this is far from *a sure thing.*

Debt, Gas Debt and Gas Prices

The national gas debt will surely feature in the round of proposals for “Ukraine bailout” being developed by the IMF, European Commission, EU member states on a bilateral basis, the US and potentially other actors, including the ECB and the UN ECE (the UN’s European economic agency), as well as private banks and energy companies. One thing is sure and certain, much higher gas prices for Ukraine are inevitable, under any scenario.

As of early January 2014, Russia’s second largest state bank, VTB, organized the first tranche of the $15 bn financial bailout, by making a $3 bn sale of Ukrainian debt bonds on the Irish Stock Exchange, guaranteed by Russia’s $88 bn sovereign-wealth National Welfare Fund, which was also tasked with financing of the $7 bn natural gas price discount and gas debt forgiveness to Ukraine in counterparty for Ukrainian starting payment of its monetized gas debt.

Current estimates of Ukraine’s total national debt stand at about $145 bn, around 80% of GDP in 2013, but late-February foreign exchange reserves were said by newswires to be only about $15 bn.

Although heavily affected by political rivalries and disputes, Yulia Tymoshenko’s two-month-only role as Ukrainian deputy prime minister responsible for fuel and energy, in 1999-2000, included her attempts at cutting back Ukraine’s constantly rising gas debt, by proposing a huge increase in gas prices inside the country. One of her proposals was for Ukraine to start paying Russia’s Gazprom $400 per thousand cubic meters (about $11 per million BTU, close to current west European prices at the major gas hubs NBP, Zeebrugge, Baumgarten).

After her “time in the political wilderness” and return to power as Prime Minister in 2007, this price was a major bargaining chip in very rocky Ukrainian negotiations with the Kremlin and Gazprom. Her supposedly “surprising” decision to pay for Ukraine’s gas through gas trading using a specially created Switzerland-based trading subsidiary, partly owned by Gazprom and major business and political figures in Ukraine – several of them “suspected of organized crime” – was a key factor in the 2009 “Ukraine-Russia gas crisis”. Tymoshenko tried a political wriggle-out by claiming there was either no outstanding Ukrainian gas debt – or that if it existed, it was now the debt of Swiss-registered company called, RusUkrEnergo.

Only for year 2008 gas deliveries, the new and additional gas debt of Ukraine towards Gazprom was estimated by analysts at about $2.4 bn. Since 2010, about the same annual rate of gas debt increase is claimed to have been racked up by Ukraine, according to Russian sources such as Alfa Bank Moscow.

Certainly at times in the long, complicated and dispute-riddled negotiations with Tymoshenko, Alexei Miller, CEO of Gazprom said his corporation could and would supply Ukraine with gas at $235 per thousand m3, but RusUkrEnergo was too attractive to Ukrainian business and political players as an opaque gas payments and trading entity able to be milked for huge kickbacks. On January 1, 2009 Russia halted all shipments of gas to Ukraine and demanded $450 per thousand m3. Then prime minister of Russia, Vladimir Putin said that $470 would be the future price, close to the 2009-price paid by many EU national gas companies “lower down the gasline”, of about $500.

Proving the extent to which this was Kremlin armtwisting of Ukraine, to make Tymoshenko close down RusUkrEnergo for reasons including this entity's total impossibility of repaying national gas debt, when gas supplies were resumed after the crisis they were billed by Gazprom at about $230 per thousand m3, far below then-current west European gas prices, and still so, today.

Even this price was however too much to pay, for Ukraine. To be sure, inside Ukraine, especially after its government collapse and the "disappearance" of its now-fugitive (for western Ukrainians) former president Yanukovych, Russia can be portrayed as cynically allowing Ukraine to run up massive, unpayable gas debts. For Gazprom however, the euros-and-cents costs of gas supplies, trade and disputes with Ukraine over the years is a black hole for corporate finances. Some analysts suggest that only for the three years 2011-2013 Ukraine's total gas debt could be $7 bn, and that writing this amount off (calling it a "friendship discount"), and returning to the previous $2.7 bn "official monetized gas debt" figure was pure political largesse by Vladimir Putin, aimed at buying Ukrainian loyalty.

The Spring Gas Crisis is Coming

Ukraine-Russia gas crises are "traditionally" short wintertime crises, which ups the ante each time, as Ukrainians start to freeze, businesses and industry shut down and the lights go out. This time however, the effects may be enduring. Ukraine's gas debt will certainly feature in negotiations aimed at relaunching the Ukrainian economy. Gas supplies to the country from Russia, under a presently far-from-impossible worst case scenario, could be terminated pending the immediate and full payment of outstanding gas debt – without "friendship discounts". Currently Ukraine is unable to pay west European gas prices or repay gas debt, or its sovereign national financial debt. To be sure, if Ukraine's gas supply is cut off, this will create havoc "further down the gasline" and reignite the energy security debates that the short but dramatic 2009 crisis triggered across Europe.

In a 26 February article "Sustaining Ukraine's Breakthrough" published by Project-syndicate, George Soros argued that Ukraine needs a modern equivalent of the Marshall Plan. He reminded his readers that while the Marshall Plan aided western Europe's recovery from the ravages of World War II, it did not include the Soviet bloc and reinforced the Cold War division of Europe. Soros said that a replay today of the Cold War would cause immense damage to both Russia and Europe, but he forgot to say that this time around, Ukraine needs a Marshall Gas Plan.

With no shadow of doubt "the gas question" will feature in what happens in the present stand-off between Putin's Russia and the west – and inside Ukraine – and will powerfully underline the energy economic interdependence of Russia and Europe.

Also sure and certain, Ukraine will pay much more for its gas, and will have to face its accumulated gas debt, as the role of seaboard LNG terminals is given more attraction due to the present crisis, underlining the geopolitical risk of international gas pipelines.

The original source of this article is [21st Century Wire]

Become a Member of Global Research

Articles by: Andrew McKillop