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## EU – UKRAINE RELATIONS:

*In the focus of energy security*



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In this issue of quarterly publication we present results of monitoring of EU-Ukraine relations dedicated to an energy security of Ukraine and EU after gas war with Russia. This publication is prepared within the framework of a joint project “Monitoring of EU-Ukraine Relations” initiated by the Regional Office of Friedrich Ebert Fund in Ukraine and Belarus and the Foreign Policy Institute of the Diplomatic Academy of Ukraine under the Ministry of Foreign Affairs of Ukraine.

The need for implementation of this project was predetermined by the need to reconsider the situation in EU-Ukraine relations, as well as the need to elaborate a new model of Ukraine’s integration strategy into EU in the framework of good neighborhood policy.

Reconsideration of Ukraine’s strategy of pursuing the EU integration course requires the development of new approaches to implementing the European standards in different areas of Ukraine’s social life to bring Ukraine closer to meeting EU membership requirements. One of such approaches is related to the formation of strategic understanding among the political elite with regard to the European vector of Ukraine’s development. Another area for implementation of European integration aspirations of Ukraine is securing broad public awareness regarding the status and prospects of Ukraine’s integration into the EU. One more important task is to raise awareness and understanding of the importance of Ukraine’s European integration by Ukrainian businesses, include them into Ukraine’s strategic thinking, and into the process of adapting Ukraine to the European market and business culture.

Regional aspects of integration tend to be an important segment of implementation of Ukraine’s EU integration objectives. In this respect the regions should be regularly informed about major events in the European Union and the EU-Ukraine relations.

To achieve these objectives the above project monitors and analyzes the EU-Ukraine relations, publishes monitoring results, and mails out findings of monitoring directly to regional government bodies, foreign diplomatic missions and NGOs.

The views expressed in this publication are those of the authors and do not necessarily reflect the views of the Foreign Policy Institute and Friedrich Ebert Fund.

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## **ENERGY SECURITY OF UKRAINE AS AN INTEGRAL PART OF ENERGY SECURITY OF EUROPEAN UNION**

At the beginning of January 2009, European consumers of Russian gas had to freeze in the ordinary sense of the word (at least, this refers to Eastern Europe). As a result, the European Union and, specifically, the European Commission, started addressing the problem of energy security in the region as thoroughly as never before. First of all – in order to make sure that such situation never happens again and to diversify (to maximum possible extent) the sources and ways of energy supply to the European Union.

Eventually, Russia's active publicity campaign almost managed to persuade the Europeans that (as usual when it comes to short supply of Russian export gas to the consumers) it was the fault of Ukraine. However, already the first attempts to clarify the essence of the problem of gas relations between Ukraine and Russian Federation, which made the Europeans freeze, revealed that situation is far from being clear. And although most the EU member states had no intention to find out who was more in fault, they had to recall the year 2006, when Russia's "GazProm" in demonstrative manner through TV broadcasting stopped gas supply to Ukraine. Back in 2006, that action of Russia lasted just 24 hours and few people in the EU could ever think that in that way Russia was trying to find out what would be the reaction of the EU and whether it would oppose such actions. Back at that time, practically everybody in the EU pretended that nothing special happened, like it was just the matter of bilateral relations between Ukraine and Russia. And it was back in 2006 when Russia realized that it can go on with dictating conditions not just to Ukraine, Belarus and some other states dependant on Russian gas, but also to the European Union. Moreover, Russia realized that such dictate can remain unpunished and started preparation for further active actions.

### ***The Debtor is Always at Fault***

After discontinuation of gas supply to Ukraine on January 1, 2006, "GazProm" and other co-owners of "RosUkrEnergo" pinned the then Ukrainian Prime Minister, Yury Ekhanurov, the Minister of Fuel and Energy of Ukraine, Ivan Plachkov, and the Chairman of National JSC "NaftoGaz Ukrainy", Oleksy Ivchenko, to the fact that henceforth all gas to Ukraine would be

supplied by intermediary company “RosUkrEnergo” (registered in Zug canton in Switzerland). Willingly or unwillingly, but this scheme was accepted. But the problem was not just the scheme itself. The problems were related to the agreement and appendices thereto, which nobody in Ukraine could get familiar with after their signing on January 3-4, 2006. *These agreements and appendices stipulated the following:*

- Ukraine, that is National JSC “Naftogaz Ukrainy” must pay the gas price set by the intermediary – “RosUkrEnergo” (initially it was \$ US 50 for 1000 cubic meters, then - \$ US 95, and finally - \$ US 130);

- For “RosUkrEnergo” the price for storing gas in subterranean storage facilities proved five times lower than in any other country and, at the same time, lower than gas storage price for other companies, specifically those that produce gas in Ukraine;

- Transit rate was set for 10 years at \$ US 1.6 for transit of 1000 cubic meters over 100 km. of Ukrainian gas lines (transit rate was raised to \$ US 1.7 only last year).

But the worst thing about 2006 agreements was that Ukraine lost the mere opportunity to conclude agreements with other gas providers, e.g. Turkmenistan. In the long run, gas transmission company “UkrTransGas” – the subsidiary of National JSC “NaftoGaz Ukrainy” – would merely transform into the executor of orders and provision of services to “RosUkrEnergo” and “GasProm”. Moreover, it was supposed to provide services at prices dictated to Ukraine by the above mentioned companies. Any attempts of Ukraine to revise the signed agreements resulted in one and the same response from “GazProm” and “RosUkrEnergo” – Ukraine receives gas at a significantly lower price compared to other countries.

At the same time, based on the above mentioned agreements concluded on January 3-4, closed joint stock company “UkrGaz-Energo” was to be established in Ukraine. Gradually, this company assumed the functions of the company “Gaz Ukrainy” (the subsidiary of National JSC “NaftoGaz Ukrainy”), which supplied gas throughout Ukraine directly to Oblast and city gas distribution companies and was expected to receive funds which would be further used to pay for imported gas. However, as a result of oral (and very seldom – written) instructions from the Chairman of “NaftoGaz” and the Minister of Fuel and Energy, Yury Boyko, the company “Gaz Ukrainy” remained the supplier of gas for utility heating enterprises, population, and budget funded organizations. These categories of consumers are called “problematic consumers”, since the state budget must annually reimburse to “NaftoGaz” the difference in prices used for population, utility heating companies and budget funded organizations. By far not always such reimbursement is paid on a timely basis. This is how it happens that “NaftoGaz” is always in debt to gas importers. Currently, “UkrGaz-Energo” received contract with the most solvent industrial enterprises that timely pay for the consumed gas. Thus, “UkrGaz-Energo” had no

problems with gas payments, especially given the fact that “RosUkrEnergo” owns 50% stake in that company and supplied gas to its subsidiary in Ukraine. Although “NaftoGaz Ukrainy” also held 50% stake in that company, it had practically no influence on actual operations of this company, especially given the fact that “UkrGaz-Energo” was chaired by Ihor Voronin, who simultaneously served as Deputy Chairman of National JSC “NaftoGaz Ukrainy” and later was also the Deputy Minister of Fuel and Energy to his colleague, Yury Boyko. Therefore, “UkrGaz-Energo” had no problems in its operations and gas payments.

However, “UkrGaz-Energo” intended to as soon as possible obtain control over Oblast and city gas distribution companies, since cash flows from consumers go exactly through these companies. Actually, “UkrGaz-Energo” was doing this in the interests of “RosUkrEnergo”. And already in 2009, when “UkrGaz-Energo” accounts have been frozen for more than half a year and the company was under court investigation, Dmytro Firtash, the co-owner of “RosUkrEnergo” declared during a program on “Inter” TV channel that he was the owner of 75% of Ukrainian domestic gas market due to the purchase of several Oblast and city gas distribution companies.

By the way, on April 24, the Security Service of Ukraine (SSU) announced about attempts of the foreign intermediaries to privatize 20 enterprises in gas supply and gasification area (oblast and city gas distribution companies) in Ukraine. SSU Chairman Valentyn Nalivaichenko informed about this at the press conference. “Yesterday, SSU sent a letter to the Prime Minister of Ukraine on how the foreign intermediaries are trying to privatize oblast gas distribution companies acting against the interests of Ukraine. Those are twenty gas distribution companies which are named specifically,” – he said. He believes that the Cabinet of Ministers must protect the interests of the state and its citizens consuming gas.

V. Nalivaichenko also mentioned that payment for gas is made but through those structures which are present in the oblast gas distribution companies in half-raider way. He stressed that payments remain in these structures and debts of oblast gas distribution companies remain in the state.

SSU considers this scheme to be criminal and intends to assist the government in its liquidation. It is known that on 11 January 2009 the owner of 45% of “RosUkrEnergo” company Dmytro Firtash said that the company acquired controlling blocks of shares in a number of oblast gas distribution companies which allowed it to concentrate around 75% of the market of natural gas supply to the end consumers.

And all this proves that even though oblast gas distribution companies formally are not owned by the foreign companies like “RosUkrEnergo”, but it is for a long time now that through

them Ukraine is being pushed into a debt prison, even after withdrawal of “RosUkrEnergO” from the scheme of gas supply into Ukraine since 19 January 2009.

### ***“GasProm” Artillery Preparation for the Cold January of 2009***

Not just “GasProm” but also management of the Russian Federation in general worked especially intensively in the international arena to impose on the Europeans the idea that Ukraine is again in debt for gas. So that in case of insufficient supply of the Russian export gas, the Europeans would know who is guilty – Ukraine.

It is interesting that until the beginning of autumn neither “RosUkrEnergO” nor “GasProm” were mentioning Ukraine’s debt for gas. And then it “all of a sudden” turned out that National JSC “NaftoGaz Ukrainy” owes over USD 500 million to the intermediary company “RosUkrEnergO”. The numbers actually were changing all the time though “NaftoGaz” did try to excuse itself and also to correct the situation. “Repressive” measures were used against the consumers – reduction of gas supply all the way up to its cutting off. With the beginning of autumn cold, it was more and more difficult to do this – natural persons and legal entities started to apply to court.

How the issue with Ukraine’s debt was finally resolved? National JSC “NaftoGaz Ukrainy” transferred the agreed-upon amount of debt to the supplier of gas – “RosUkrEnergO” company. The latter would have to transfer full amount to “GasProm”. But there appeared the legal collisions due to which though the funds were transferred but were not reckoned in full by “GasProm”. As a result of this, the Russian gas monopoly started its more active accusations of the Ukrainian side. Because it knew for sure that National JSC “NaftoGaz Ukrainy” has paid on all its debts.

It is already known today that after inspection by the Accounting Chamber of the Russian Federation, “RosUkrEnergO” company has positive balance of debt to “GasProm” in the amount of USD 514.16 million. In total, as of 6 February 2009, “RosUkrEnergO” debt to “GasProm” group was USD 1.054 billion. “GasProm”, in its turn, owes “RosUkrEnergO” USD 540.53 million. And this is not related to Ukraine, this is about foreign contracts of “GasProm” and “RosUkrEnergO” outside Ukraine. As “RosUkrEnergO” did supply gas – with “GasExport” permission (100% export subsidiary of “GasProm”) – to Poland and Hungary.

The latter, particularly, became the reason for “RosUkrEnergO” claim to National JSC “NaftoGaz Ukrainy” in Stockholm Court of Arbitration. “RosUkrEnergO” continues to insist

that as a result of Ukraine's allegedly not fulfilling instructions on gas withdrawal from UGS (underground gas storages), there was insufficient supply of gas to Poland and Hungary. In its turn, "RosUkrEnergo" has accrued a fine on "NaftoGas" in the amount of almost USD 600 million. And nobody takes into account that the agreement with "NaftoGas" was non-transparent, because "NaftoGas" – upon the terms of this agreement – has no right to impose sanctions on "RosUkrEnergo" or "GasProm".

Therefore, it turns out that "GasProm" intended to sort out its relations with "RosUkrEnergo", and Ukraine was suffering though it had no direct business relations with "GasProm" since at least 2006.

### ***Why Direct Gas Contracts for 2009 with "GasProm" Were Not Concluded on December 31?***

Actually, nobody has given a clear answer to this question. Everything came down to fight for "gas superiority" between the Prime Minister and the Presidential team. It is known that the agreement on gas supply to Ukraine and on transit of Russian gas across the Ukrainian territory between National JSC "NaftoGaz Ukrainy" and "GasProm" was prepared for signing. Moreover, Yulia Tymoshenko personally was prepared to be present on 31 December 2008 during signing of both agreements. Even the airplane was ready for her. But ... it did not work out.

Though those unsigned agreements contained the gas price for Ukraine not higher than USD 230. They also envisaged removal from the scheme of gas supply to Ukraine of the intermediary "RosUkrEnergo". And also a privileged three-year period for Ukraine for gradual increase of prices up to the market level.

All this was changed on 19 January 2009 when for the first time the contracts were signed between "Naftogas" and "Gasprom". But this was preceded by a couple of events significant for Ukraine and European Union. And regarding discord in the Ukrainian power, this factor has seriously affected the interests of Ukraine, in particular, in the area of energy safety.

### ***GTS of Ukraine Has Proven Its Capability***

On January 6 when "GasProm" already turned off supply of gas to Ukraine and was preparing to turn off the transit gas flow, the Joint Dispatch Department (JDD) of



“UkrTransGas” (gas transportation enterprise of National JSC “NaftoGaz Ukrainy”) and the Department of Gas-Main Pipelines “CherkasyTransGas”, “LvivTransGas” and “PrykarpattyaTransGas”, the gas transportation system (GTS) of Ukraine switched to not just autonomous but reverse regime of work.

Previously, gas was mainly transported from the East to the West (including transit), but in January the Eastern regions were receiving gas from the underground gas storages (UGS) located in the West of Ukraine. Therefore, while “GasProm” was actively preparing for informational war with Ukraine, National JSC “NaftoGaz Ukrainy” and the Government were filling the underground storages with gas. Nothing like that has ever happened before in the same scale (reverse use of GTS).

Because, according to “Dzerkalo Tyzhnya” information, Vladimir Putin was assured: as soon as export of gas through Ukraine will stop, already on January 8, the Ukrainian GTS will “lie down” and will be unable to transfer gas from its Western underground storages to the East and South of Ukraine. For when the system operates in a stable regime, the volume of gas withdrawn in the East from the export flow for the needs of the region is later replenished from the stocks of UGS in the West of Ukraine. But the Ukrainian GTS withstood.

When “GasProm” stopped supply of gas to Ukraine, it immediately started accusing us of stealing gas from the export flow. They even managed to accrue multi-million debts on us just for the first week of January 2009.

Though Oleg Dubyna, Chairman of National JSC “NaftoGaz Ukrainy”, has explained clearly on the very first days that for transportation of export Russian gas it is still necessary to maintain certain pressure in gas pipelines. And for this purpose, it is necessary that the gas-compressor stations use technical gas, or the so called “gas for internal needs”. National JSC “NaftoGaz Ukrainy” had to withdraw for this purpose around 50 mln m<sup>3</sup> of natural gas.

How it was in the previous two years: “UkrTransGas” purchased technological gas from the same “GasProm”. In January, neither “GasProm” nor “RosUkrEnergo” supplied gas to us. And the reason is that back in January 2006 Igor Voronin signed additional agreements with “GasProm”, according to one of them the Ukrainian side undertook to supply GTS with technological gas itself until 2028. And it was doing so since 2006, receiving from “GasProm” a tiny payment in the form of tariff for transit of 1,000 m<sup>3</sup> of gas for 100 km of gas pipelines. It is known that in January the Kyiv court recognized I. Voronin’s signature invalid, therefore, recognized void were also agreements under which the previously existing connection between transit rate, gas price for Ukraine and “GasProm” obligation to ensure balance of gas for Ukraine was terminated. We remember that at that time Ukraine received annually as payment for

transit services about 26 bn m<sup>3</sup> of gas. And it disposed of this gas itself, including its use for the needs of its gas transportation system.

And today, after decision of the Kyiv court, we return to the old agreement base. I.e. the framework contract between “NaftoGas” and “GasProm” signed in 2003. According to this document, both companies must conclude annually an additional agreement, on the basis of inter-governmental one, in which the transit rate is specified. And minimum annual volume of gas transit through Ukraine is set as not less than 100 bn m<sup>3</sup>.

### ***History of Events***

So, on January 1, “GasProm” stops delivery of gas for the needs of Ukraine. Pressure in the gas transportation system begins to decrease. Also, at the same time, there appeared the situation abnormal for gas industry – special direct communication between the Dispatch Departments of “GasProm” and “NaftoGas” is cut off. Gas transportation specialists say they cannot remember anything like that for the whole history of this industry.

Already on January 6, receipt of gas in the Ukrainian GTS was only 51.2 mln m<sup>3</sup>. And on January 7, the Russian Federation stopped gas supply completely. On January 8, the Ukrainian delegation in Brussels reaches an agreement on creation of the monitoring expert group.

On January 9-11, the then Prime Minister of Czech Republic which is chairing the EU visited Ukraine. Prime Minister Yulia Tymoshenko and President Victor Yushchenko conducted gas negotiations with him regarding signing of tri-lateral Protocol between Ukraine, Russia and EU.

Meanwhile, gas supply for the largest industrial consumers of natural gas in Ukraine was decreased to the level of technological reservation. Those who were able transferred their production to use of residual fuel oil or other fuels alternative to gas. After termination by “GasProm” of gas supply in direction of Ukraine, the volume of technological gas in the Ukrainian GTS reduced from 1 bn m<sup>3</sup> to 850 mln, critical level being 800 mln m<sup>3</sup>. Gas withdrawal from UGS is done in maximum volumes, and gas extraction is increased to the maximum – from 56-58 mln m<sup>3</sup> a day to 61 mln m<sup>3</sup>.

### ***Experts and Monitoring***

It is known that already on 8 January, Ukraine and the European Commission (EC) signed in Brussels the Protocol on presence of the European observers at the objects of the Ukrainian gas transportation system. Later, despite the fact that three-day negotiations between "GasProm"

and "NaftoGas" ended without any result, representatives of the European Commission, Cabinet of Ministers of Ukraine and the Russian Federation Government signed another Protocol on establishment of the international commission on control over transportation of Russian gas through the territory of Ukraine. The document envisaged establishment of a task force consisting of 25 experts from each side. It was expected that monitoring will be done in the territory of Ukraine at the gas-measuring stations (GMS) in Orlinka, Tekove, Uzhgorod, Berehove and Drozdovychy. Monitoring was also to be done at the Russian GMS located in Sokhranovka, Sudzha, Pisarevka, Valuyki and Platovo.

Information on the results of monitoring was to be transferred in online regime to the relevant institutions in Kyiv, Brussels and Moscow. The parties agreed to pay expenses for activities of their own observers.

On *January 11*, monitoring groups of EC and accredited Ukrainian and Russian specialists visited the gas-measuring stations of Sudzha (Kursk oblast, RF) and Pisarevka (Voronezh oblast, RF). *At Pisarevka GMS, Gerald Linke, Head of the group, confirmed the fact of absence of gas supply from the RF territory to Ukraine.* The next day, EC experts started their work at GMS located in the Western and Southern regions of Ukraine located on the border with EU countries – gas-measuring stations in Drozdovychy, Uzhgorod, Berehove, Tekove and Orlivka. They keep on working now. In addition to representatives of the European Commission, the group of experts which conducts monitoring includes also one representative of the following gas transportation and gas trading companies: SPP a.s. (Slovakia), "GasProm Export" (RF), Estrim, Gaz de France Suez, RWE Transgaz (Czech Republic), VNG, OMV and WINGAS (all of them — Germany), two representatives of Gaz de France (France), three representatives of E.ON (Germany), and also the leading party of 25 "GasProm" specialists.

### ***Between "GasProm" and ... "GasProm"***

When we speak of the European experts who conduct monitoring in Ukraine, we should remember that among them there is a significant number of representatives of those companies which are directly or indirectly related to "GasProm". Suffice it to say that in dozens of gas transportation and gas distribution companies of the European countries the Russian monopoly holds different blocks of shares. For instance, "GasProm" owns 35% of shares in Wingas Gmb Company.

Penetration of the Russian company into European gas market is very deep. So, it is very difficult to expect a single and unbiased decision of international experts in respect of Ukraine's actions in the conflict with "GasProm", because in fact, in this confrontation, Ukraine finds itself

between "GasProm" and ... "GasProm" which is interested in appropriation of the Ukrainian gas transportation system. In order to make sure that it is so, it is worth to look closer at relations between "GasProm" and some European gas companies.

**SPP a.s. (Slovakia).** "GasProm Export" and Slovensky plynarensky priemysel a.s. (SPP, 51% belongs to the Republic of Slovakia, 49% — to consortium E.ON Ruhrgas i Gaz de France) signed in November 2008 an agreement on key terms of gas supply to Slovakia for the next 20 years. An agreement on transit of the Russian blue fuel with a transport subsidiary of SPP – company Estream – was concluded for the same period of time. But for this Bratislava gave to the Russian monopoly 49% of shares of the national oil transportation company Transpetrol (former asset of YuKOS) in exchange for a special approach in formation of gas prices.

Indirect confirmations of this are the statements of Robert Fitso, Prime Minister of Slovakia, made by him after the meeting with Vladimir Putin. A central subject of negotiations was an announced conclusion of the new contract for gas supply. But according to information of some mass media, possibility of selling shares of Transpetrol to "GasProm" without an open competition was discussed. When leaving Novo-Ogaryovo, a Slovakian official said with pleasure that he was able to receive guarantees of a new contract and new gas price. No wonder that Mr. Fitso was very negative when speaking about Ukraine...

**RWE Transgas a. s. (Czech Republic).** Do you remember that first European attempts to intercede "NaftoGas" and "GasProm" were made by the Premier of Czech Republic which is now chairing in the European Union? But on the eve of gas conflict, a conflict between gas companies for access to underground gas storages in Czechia started in the domestic gas market of Czech Republic.

German concern RWE AG which controls major part of gas market of Czech Republic is being inspected by the Czech regulatory bodies. The reasons for this inspection were complaints of the gas market participants in the capital of which "GasProm" participates through its structures. They expressed their dissatisfaction with restricted access to underground gas storages in Czech Republic. The reason for investigation of activities of RWE in the Czech gas market were complaints of two gas distribution companies — Jihoceska Plynarenska a.s. and Prazska Plynarenska a.s., co-owner of which is the German concern E.ON AG and trading company Vemex, in the capital of which "GasProm" takes part. These companies complained about restricted access to UGS in Czech Republic. As a result, inspection of business of the German concern in Czech Republic was started by the antimonopoly authority of the country, and also by the body responsible for energy sector regulation. Last year, a USD 12 million fine was already imposed on RWE for violation of competition rules. This was the highest fine ever imposed on a company in Czech Republic.

Possibility to store gas in direct vicinity of key sale markets is advantageous to "GasProm" as it allows it to reach maximum flexibility in the issues of timely supply of consumers with gas in the periods of peak demand. Czech Republic is the most important transit point on the way of Russian gas to Germany – the largest consumer of the Russian blue fuel. That is why possibility to store gas in the Czech territory is very important for "GasProm".

**OMV AG — OMV Gas International.** "GasProm" received a 50% stake in the Central European Gas Hub (CEGH) located in Baumgarten. Previously, 100% of CEGH was owned by a subsidiary of OMV AG — OMV Gas International.

**E. ON Ruhrgas AG (Germany)** — is the largest energy and gas company in the world which is privately owned. E.ON Ruhrgas AG — is a subsidiary of E.ON responsible for gas transportation business in Europe. It is the largest gas distributor in Germany and one of the leading distributors in Europe. E.ON Ruhrgas has well-diversified long-term portfolio of contracts for gas supply and maintains close relationship with powerful suppliers of natural gas, including Russia and Norway. Some of the contracts were concluded for the period up to 2036. E.ON Ruhrgas company buys natural gas from Russia for 30 years already and is the largest foreign shareholder of OJSC "GasProm" (6.4%). E.ON AG will receive 25% minus one common registered share in the statutory capital of OJSC "SeverNefteGasProm" and, therefore, will take part in development of the South-Russian gas field. As it is seen from above information, the companies whose experts work in the international monitoring group are not strangers to "GasProm".

### ***Reverse or Export***

After arrival of the European monitoring group, "GasProm" had no other options than "make" Ukraine guilty again in non-resuming export of Russian gas. And they informed JDD of "UkrTransGas" that on January 13 they will begin pumping 76 mln m<sup>3</sup> a day in the direction Sudzha-Orlivka. Later, this number of the Russians was increased to almost 100 mln. They understood then very well that for the Ukrainian GTS which at that time was working in a closed regime, this routing with such minimum volumes was a stupid task from the technological point of view. At that time, GTS was already operating in a reverse regime in order not to freeze six Eastern oblasts, including Donetsk, Luhansk, Dnipropetrovsk, Mykolaiv, Kharkiv, part of Zaporizhyya oblast and Crimea.

In order to switch GTS again to export, in addition to 36-hour time period, it is necessary to have permanent daily volume of gas "in the pipe" of not less than 300 mln m<sup>3</sup>. And "GasProm" suggests to transport only up to 100 mln m<sup>3</sup>. Non-recurrently?!

So, it is completely logical that “UkrTransGas” JDD replied: either give us guarantees that this is not a one-time operation, or we will not do this. "GasProm" would not settle down. And immediately there started accusations in address of Ukraine that its GTS is technically unable to transport Russian gas. The Ukrainian side answered these accusations with quite a logical proposal to conclude at least Temporary Technical Agreement between OJSC "GasProm" and National JSC “NaftoGaz Ukrainy” on the terms of delivery/receipt of natural gas at the border gas measuring stations for its transit through the territory of Ukraine in January 2009. The necessity to conclude this temporary agreement was obvious: in order to transport anything, it was necessary to fill the Ukrainian GTS with sufficient volume of gas and to increase pressure in gas pipeline.

"GasProm" would not sign the technical agreements all the time until April. But it did require government guarantees for payment for technical gas necessary for resuming of gas transit to Europe. Yulia Tymoshenko informed "GasProm" on April 14 that the Ukrainian government guarantees payment for technical gas at the price which the parties will agree on later during conclusion of the contract and technical agreement for 2009.

Trying to stop the endless row of accusations in address of Ukraine, which allegedly was impeding consciously to resume transit of Russian gas to Europe, “UkrTransGas” sent on January 15 a fax message to "GasProm" and explained composedly that the Ukrainian side is prepared to resume transit. And also asks to open major part of gas-main pipelines which enter Ukraine in order to fill the gas transportation system up to the necessary level and to open its work in obverse regime. *“UkrTransGas” also explained its position to representatives of the European Commission, and found there certain understanding.*

But in "GasProm", they did not focus attention on all “UkrTransGas” proposals, especially on the need to sign a temporary technical agreement. Probably, situation with gas supply to EU could have remained unresolved for a long time but finally the European Commission and EU member-countries started asking "GasProm" aggrievedly why it did not fulfill its obligations on gas supply to EU countries? And finally, on the night of 19-20 January 2009, two contracts with "GasProm" and two additional agreements were signed.

### ***Gas Contracts with "GasProm" Signed on January 19***

So, on 19-20 January 2009, National JSC “NaftoGaz Ukrainy” and "GasProm" signed the contracts: on supply of gas to Ukraine in 2009-2019, and on transit of Russian gas through the

territory of Ukraine for the same period of time. And also additional agreements on 11 bn m<sup>3</sup> of gas in the Ukrainian underground storages (UGS) to be discussed later.

*Key achievements of the signed contracts are as follows:*

- establishment of the formula for gas price for Ukraine;*
- elimination of the intermediary – “RosUkrEnergo”;*
- stipulation of the volume of Russian gas import by “NaftoGas” for the needs of Ukraine;*
- minimum guaranteed volume of gas transit through the territory of Ukraine;*
- long-term (10 years) agreements which allows Ukraine to plan work of its GTS.*

***But unfortunately, the signed agreements are not transparent. This also concerns fines envisaged in general only with respect to Ukraine, and transit rate for Russian gas which remains on the level of 2008 – USD 1.7.*** The only hope is that prices and volumes may be reviewed annually. Therefore, with time, Ukraine will be able to raise the issues on other details of the contracts.

**Gas price for Ukraine.** Before looking at the options of pricing (adopted and discussed ones), let us specify that in 2009 “NaftoGas” intends to buy from "GasProm" 40 bn m<sup>3</sup> of gas. We will also remind about reserves in UGS and about 20 bn m<sup>3</sup> of annual own extraction. And planned amount of purchase for 2010 is 52 bn m<sup>3</sup> of imported gas at the price which will exist at that time.

Due to gas reserves in UGS, National JSC “NaftoGaz Ukrainy” intended to buy in the first quarter of 2009 only 5 bn m<sup>3</sup> of gas. According to the Prime Minister’s version, this was expected to soften a price strike on the domestic gas consumers. In the second quarter – 10.5 bn m<sup>3</sup>, in the third quarter – 12 bn m<sup>3</sup> and half a billion more in the fourth quarter, in order to manage to replenish reserves of the underground storages by the next winter. And in 2010, according to the contract, the situation may be different: import in the first quarter – 16.2 bn m<sup>3</sup>, in the second – 10.8, in the third – 10, and in the fourth 15 bn m<sup>3</sup> of gas.

Contract price (P<sub>n</sub>) in USD for 1,000 m<sup>3</sup> of gas for Ukraine is USD 450. And there is also a ratio which in 2009 is 0.8 (this is exactly 20% "GasProm" discount from USD 450 price), and from 2010 it will be 1.0, in 2011 it is unknown how it will change. And every time the price of USD 450 for 1,000 m<sup>3</sup> of gas will be mentioned as basic price for the formula  **$P_n = P_0(0,5 \times G /$**

$G0 + 0,5 \times M / M0) \times k^1$ . Contract price  $P_n$  is determined as of 1 January, 1 April, 1 July and 1 October on every year of supply and is valid through the relevant quarter of the year of supply.

In addition, "NaftoGas" is put by the contract in very strict conditions: should it not pay to "GasProm" on time, the fines will be 0.03% for every day of delinquency. In addition to accrual of fines, "GasProm" will stop supply of gas to Ukraine ... on the 7<sup>th</sup> day of the next month.

After signing of the agreements between "NaftoGas" and "GasProm", the citizens of Ukraine were concerned with the following question: so, what will be the price of gas at least for the households?

Prime Minister Yu. Tymoshenko announced a "year average" price – USD 228.8 for 1,000 m<sup>3</sup> at the Ukrainian-Russian border. This is without all taxes and mandatory payments. But there is also another calculation, according to which in the second quarter of 2009 price for 1,000 m<sup>3</sup> may be USD 323.03, in the third quarter – USD 241.5, and in the fourth quarter – USD 152.12. And this is without taxes and transportation expenses too.

To the best of our knowledge, National JSC "NaftoGaz Ukrainy" from the very beginning was suggesting to use the so called Austrian formula. Peculiarity is that in case of use of the Austrian formula, transit rate for "GasProm" would be not less than USD 5 for 1,000 m<sup>3</sup> per 100 km of gas pipeline. That is why "GasProm" wanted to prove by all means that everything is different. But there is also a different approach to formation of price and transit rate.

As far as volume of gas transit is concerned, it should be 100-120 bn m<sup>3</sup> in 2009. In the nearest years, these numbers should not change significantly. But already this year the volume of gas transit has been significantly reduced. At least now, Ukraine is buying less Russian gas too.

Should it be the same in future, Ukraine will have to pay even for gas which it is not buying (because the contract on "take or pay" terms envisages payment for not less than 80% of the contract volume of gas). While "GasProm" does not have similar obligations to "NaftoGas" in respect of transit volumes, therefore reduction of transit flow through Ukraine as a result of shortened EU demand does not threaten the Russians at all. **This also demonstrates non-transparency of the Russian-Ukrainian gas agreements.**

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<sup>1</sup> P0 — basic price in the amount of USD 450 for 1,000 m<sup>3</sup> of gas;

G0 — parameter which numerically equals an arithmetic mean value of prices for gasoil 0.1 in USD for a metric ton in the base period of 9 months from April to December;

G — parameter which numerically equals an arithmetic mean value of monthly prices for gasoil 0.1 in USD for a metric ton for 9 months;

M0 — parameter which numerically equals an arithmetic mean value of prices for fuel oil with 1% sulphur in USD for a metric ton in the base period;

k — ratio which equals 0.8 in 2009, and 1.0 – from 2010.



## *Independence or Survival?*

This is an old question for Ukraine. As famous British analyst James Sherr mentions, until recently, it was believed that the post-communist states formed on the ruins of former Soviet Union may preserve their independence which will bring them prosperity, and those expectations were based on two pillars of faith: first of all, faith that these countries will have sufficient will, and later – responsibility and wisdom to reach the established goal. And secondly, faith that the developed democratic countries will undertake the role of guarantors and guardians, and they will have enough nobility, determination and far-sightedness to assist those countries and to give them the required support.

But today these pillars of faith have started to ruin. The West today is not so self-confident, and its role and importance are not the same as before. Countries of the European Union are facing a full-size threat of international terrorism, not to mention their internal challenges, and NATO has transformed from the regional military block into an international player. This block has experienced two waves of expansion, and each of them enriched Europe in its own way, but simultaneously added new problems and reduced the scale of expectations. Leaders of the countries are no longer prepared to take risks, and on the other side of the Atlantic those who are still willing to take risks – Bush, Cheney and Rumsfeld – have discouraged Europe from defending its position, not to mention confrontations.

Events after the revolution of roses and orange revolution did not bring anything except disappointment to many people. The West has practically lost interest to everything which takes place on the other bank of Prut river, and one can hardly hear from them indignant voices about ambitions and intentions of the Russian management. Should everything be different, the global economic crisis would not cause so many uncertainties and problems that the governments of European countries are facing now.

So, it should not be surprising that for the second time in the last five months the event which was inevitable came as complete surprise. *When on January 1 "GasProm" cut off supply of natural gas to Ukraine, for political leaders of Europe it was almost as unexpected as the beginning of war in Georgia in August last year. The Europeans appeared to be absolutely unprepared for the fact that this conflict may get so far – all the way to complete termination of gas supply to Europe which occurred on January 7, just like it was in case with Georgia.* Yes, the European Union countries did not expect that. And while they have at least some explanations on this, Ukraine has nothing to excuse itself.

And again, *internal policy factor* has played its role. Before the Russian-Ukrainian gas conflict outgrew into the crisis, and the crisis lead to complete termination of natural gas supply to the European consumers, the Ukrainian power and official representatives have demonstrated unacceptable deliberation. The reason for this was the problem of distribution of powers in Ukraine, and this by no means can be considered an excuse. In any case, they should have started negotiations and conduct them professionally, using all the intellect and experience they have, revealing all the lies, firmly defending their position and preserving confidence of the partners.

But the notorious defects such as indetermination, incompetency, evasion and deliberation, as well as unforgettable hope for someone who will resolve the problems instead of Ukraine itself, - have lead to the situation when probation turned into a real catastrophe. This has cost Ukraine not only loss of respect of Europe but, taking into account weakness of the European community itself, also called in question the very future of Ukraine.

Both European Union and Ukraine assumed that January 2009 crisis will be a mere repetition of 2006 crisis. Should it be so, wrote Mr. Sherr then, today events are a logical continuation of the Russian-Georgian conflict of 2008. But in this case, there are at least three key issues which differ current situation from 2006 situation.

*Firstly*, Russia unleashed this gas war in desperation. In the period from June to October last year, corporate shares in the Russian stock market lost 70% of their value, world oil price dropped from USD 147 to USD 48 per barrel, and after depreciation of "GasProm" shares by 76% there was raised a question about its transfer from state ownership into private hands. Under such circumstances, it is impossible to resolve today structural problems of the Russian energy sector that nobody was concerned about in the times of stability and prosperity. This, in its turn, questions expediency of building gas pipelines "Nord Stream" and "South Stream" to bypass Ukraine. In this case, "GasProm" is first of all interested in money and less so – in the rest. ***And once it is impossible to avoid the Ukrainian gas transportation system as even "Nord Stream" and "South Stream" will be unable to undertake the full volume of gas transit to Europe, - it is necessary to take it under control. And, finally, should construction of these two gas pipelines be eventually completed, Europe should be persuaded that the Ukrainian gas transportation system not only stands in the way of the Russian leaders' ambitions, but also jeopardizes safety of Europe itself.*** Russia always acted according to the principle "if you try to break through several doors simultaneously, one door may surrender". That is why in this desperate situation Moscow set several goals for itself. And the situation also gives it some opportunities. In order to achieve these goals, its political leadership, unlike European Union leadership, is prepared to take risks. And for it – just like for "GasProm" – significant but short-

term losses incurred by "GasProm" as a result of termination of gas supply – is an acceptable and justified risk.

*Secondly*, Russia lately was paying a lot of attention to public relations, relations with mass media and relations on the international level. As distinguished from its actions in 2006, representatives of Russia clearly and persuasively expressed their position and constantly kept the governments of European countries informed. On the first days of January (when London bureau of CNN could not find a single representative of Ukraine for an interview), they insisted that Ukraine is siphoning gas designated for the European consumers, and permanently stressed on Ukraine's unreliability as a transit country. In this situation, Ukraine was doing its best to undermine its position in the conflict: apart from the rumors and wild guesses, Ukraine did not provide any official information on what really happened during December negotiations. Thus, Europe trusted Russia in what it was saying: that Russia suggested a USD 250 price for all gas consumed by Ukraine. Though it related obviously only to gas purchased by "GasProm" in the territory of Russia, and not the mixture of Russian and Turkmen gas with significant prevailing of the latter. Therefore, instead of waking up in the New Year and see that Russia speaks the language of ultimatums, violates the effective agreements and that the new price will be almost twice as high as the previously "proposed" price, - many of the Europeans believe the fairy tale of the Russian generosity and Ukrainian stupidity.

Instead of explaining all the difficulties connected with pumping of the limited gas volumes through one of the most complicated integrated gas transportation systems in the world which Ukraine has, its representatives preferred to keep silent until Russia began to accuse Kyiv of gas theft. But even then they presumably took refuge in silence, while "technical gas" in Europe became almost a synonym for "stolen gas".

Nobody in Ukraine took an effort to disclose all the cynicism of the proposed by "GasProm" scheme of gas transportation along the route on which it was transported to the consumers of South-Eastern Europe in the period of January 1-6, and then on January 13. Instead of this, some people just received the print-outs of the history of "events on January 13".

Who did not know in Europe that Ukraine was forced to switch its whole gas transportation system into reverse regime in order to supply with its own gas the regions in the South and East of the country? Who knew that Ukraine was supplying gas to Moldova from its own gas storages? Practically nobody. And though President Victor Yushenko maintained "constant dialogue" with the Chairman of the European Commission Barroso, does he really believe that the European officials overloaded with their own problems would find time and will be able to correct the mistakes made by Ukraine through its keeping silent?

*Thirdly*, Russia now has much stronger positions in the region than in 2006. The issue of NATO expansion can be considered closed for the nearest future. The grounded fears of the European Union about Russia rather force it to look for reconciliation than confrontation. And as for Ukraine, its indetermination in defending its positions today is more vivid than it was three years ago. Political crisis became very often here, and its economic crisis is becoming threatening in its scale, while the European Union is gradually losing patience in relation with the guideless country whose problems are presumably born by the country itself.

*As for EU sensitiveness about energy safety, in order to guarantee this safety, the European Commission approved the Concept of European Energy Policy, and the Council of Europe approved the Action Plan. But generally it is obvious that a lot is being said about it but practically nothing is done.* USA was focused exclusively on its own problems connected with election of the new President. Therefore, like in Georgia in 2008, all the fears, unfaith, potency and craftiness of Russia were focused in one point in order to fulfill the only task: ***to undermine reputation of Ukraine as a gas transit country, to lay hands on its gas transportation system and gas storages, and to convince Europe that in order to achieve stability in this area for a long-term perspective it needs the Russian gas pipelines and preservation of the Russian leadership as a supplier of energy resources.***

It is possible to draw some more parallels to the Georgian conflict which should alert Europe, and alert Ukraine:

— this is use of the so called reflexive control which military science defines as “enemy defeat by its own forces”. In both cases, weak spots of the enemy (“Georgian opportunism” and “chaos and anarchy” in Ukraine) were thoroughly analyzed, and later, in caricature and ominous form presented to international community as the key reason of all problems;

— transfer on the initial stage of crisis from, at first sight, cautious and weighted policy to implementation of the plan of revenge and punishment. This inability to predict the results which was demonstrated by Russia earlier when it recognized independence of South Ossetia and Abkhazia, lead on January 7 to complete termination of Russian gas supply to the European consumers through the Ukrainian territory. The question is whether it was a hypertrophic manifestation of the Russian “offence”, or Russia decided to expand the sphere of application of “reflexive control” principle also to Europe which is scared of Moscow anger and behavior irrationality?

— striving to use the revenge and punishment policy — all the way to ruining of the opponent country’s economy and infringement of its territorial integrity;

— *on the peak of situation – attempts to win Europe on its side through use of uncertainty of its position, to move the pointers of European support into a neutral position;*

— confirmation of Putin’s status of the nation’s leader right at the moment when this status was in question.

There can be moments when difference between grounded and ungrounded fears can determine a border between survival and destruction. And this moment has come. If Ukraine is unable to understand itself and its surrounding, it has lost a lot already and risks to lose even more.

Two of such ungrounded fears are already actively pressed in the public discussions on this subject. Firstly, this is the topic of betrayal. Allegedly Yulia Tymoshenko, with Putin’s help, betrayed the national interests and instead of a beneficial contract returned to Ukraine with disadvantageous contract. But she signed what she signed not because of her ambitions or incompetency but because she simply had no other choice. With its claims to resume gas supply, the European Union actually threw her into the lion’s lie, and left Ukraine without heat. If previously Putin used the Ukrainian contradictions to form alliances advantageous for him, today, he just needs it to discredit the neighboring country and to damage its international relations. He does not trust anybody in Ukraine, and Tymoshenko is no exception. The only thing he counts on and uses for his benefit is weakness. And killing of “RosUkrEnergo” which has already died several times before but is still alive today, is not a cession, it is just a sign that Moscow no longer requires its services. And Tymoshenko will win if she stops talking about “long-expected shifts on the Kremlin’s side” and will be able to unite and mobilize the country.

Secondly, this is alleged inability of Ukraine to do anything in the current situation. Though, it is worth mentioning that this statement today has a lot more grounds than before. Europe must finally understand that conflicts of this level cannot be independently resolved by Russia and Ukraine. *But until Ukraine becomes a serious player for whom a priority are national and not clannish interests, and until a pragmatic approach to elimination of its own weaknesses and deficiencies will prevail, there will be no support of the European Union, or it will be just symbolical.*

But there are two fears which really have grounds. And whole Europe must clearly understand that. *First of all*, even upon the condition of unity of the highest branches of state power, *it will be difficult for Ukraine to observe all provisions of the achieved agreement in its current form.* If Tymoshenko’s information on gas price (USD 228 on the border with Russia till the end of the year) will not be confirmed, a new price will be exorbitant for Ukraine. According to some Russian sources gas price will be inevitably increased twice. Ukraine will be unable to pay this money even if gas price drops below USD 250. Also, it is necessary to take into account that gas price is fixed in US dollars while settlements in the domestic market are made in UAH which depreciated from UAH 4.9 to USD 1 in September to UAH 9.6 at the year end. As a

result of the world economic crisis, GDP level reduced in November by 14% compared to the same period of 2007, and throughout the country significant reduction of industrial production is observed. Therefore, “NaftoGas” debts will continue to grow, and soon the crisis may occur again.

*Secondly*, these are completely grounded fears that escalation will continue and that the situation may get out of hand. In addition to economical crisis (which itself is a catalyst of dissatisfaction and transfer of economic conflicts into political angle), the problems with energy carriers supply will become a survival test for already weak institutes of state power in Ukraine and for its civil society. Most probably, Moscow will strive for regulation of its pressure on Ukraine through the cessions and agreements, for instance “privileged” investments in development of the new Ukrainian gas fields or extended presence of the Black Sea fleet in the Ukrainian territory after 2017. Though, the Russian special services may try to achieve this with the old tested methods. But most probably they will not succeed. It will hardly get to a catastrophe but the situation may have very dangerous consequences for stability in Ukraine, and for safety of the whole region.

In consideration of these threats, both Ukraine and the European Union should decide for themselves in which direction to go. ***Europe should refuse from the myth that gas relations of Russia-Ukraine-Europe triangle can be separated form gas relations between Russia and Ukraine. Europe should recognize that these relations are an important and inseparable part of the European safety, and to design its policy in this regard.*** It should understand that in absence of economic and financial losses, the damage caused to the image and reputation of Russia, as practice shows, will hardly have any significant effect on its behavior with its business partners. *Therefore, Europe should concentrate its efforts on five key directions:*

- it is necessary to review fundamentals of its energy policy with respect to Russia;
- it is necessary to warn Russia that until Moscow does not ratify the European Energy Charter, Europe will block all steps of the companies controlled by the Russian government that will be aimed at further acquisition of assets in energy infrastructure of the European Union;
- it is necessary to develop and approve the temporary scheme of settlements to cover short-term debts of Ukraine to "GasProm", thus reducing pressure on its economy and infrastructure;
- it is necessary to tie development of such mechanism to establishment of the joint Ukraine-EU commission to deal with the matters of control and reforming of the bulky and ineffective energy system of Ukraine. Upon the condition of adoption by Ukraine of the coordinated goals and mechanisms of control over fulfillment of agreements, it is necessary to provide Ukraine with financial resources and expert support for exercising control over this

system and its gradual transformation into profitable, energy saving and attractive for investments system;

— through use of such mechanisms and leverages, Europe should strive for conclusion of long-term contracts for supply of energy carriers from Russia to Ukraine on the same terms as similar contracts concluded by Russia with EU countries, i.e. on the basis of a stable and transparent formula for formation of prices and tariffs, mechanism for price review and procedure for appeal of the decisions and fulfillment of contracts.

Today, when the European Union in person of Energy Commissioner Andris Piebalgs confirmed what Ukraine itself was unable to prove – that during the crisis “NaftoGas” did not siphon Russian gas, logics and necessity of practical implementation of such measures becomes even more obvious. And with election of Barack Obama a new US President, Washington may no longer count on Europe acting, like before, in unison with America, and that their relations will be beneficial for strategic interests of Ukraine. The first steps in this direction have already been made by Ukraine and the European Union.

But the Russians did not rest. Already on April 20, they announced about a new basic document on energy cooperation which is suggested by Russia as a framework for energy relations instead of 1991 Energy Charter and which outlines additional liability of the transit countries. As Russian President Dmitry Medvedev stated during his visit to Finland, the document was transferred to the government of Finland and will be sent shortly to the members of G-20, CIS countries, as well as all active players in the energy market. Arkady Dvorkovich, assistant to the President explained that novelty of this document is in extension of the list of energy resources: it is no longer just oil and gas but also nuclear fuel, electric energy and coal. Russia also suggests to extend the list of countries and to include in it the leading energy players, such as USA, Canada, China, India and Norway.

***An especially important item for Russia in the new document is resolution of conflict situations and additional liability of the transit countries. This item is important after January gas conflict with Ukraine and signing of the declaration between Ukraine and EU on modernization of the Ukrainian gas transportation system which Russia is not a party to.***

Legal structure of the document offered by Russia is not clear yet. Dvorkovich explains that the form still needs to be discussed. In the nearest future, the Charter will be discussed at several large international forums, he says. “If Russia ratified the Energy Charter (like it was planned in 1997), we would be restricted with some obligations on nuclear materials, and our partners would have no restrictions,” said Dvorkovich. The new agreement will allow to “lay a

strong foundation for more beneficial partnership in energy area without any political conditions,” he said.

In the current Charter, there is no effective mechanism of sanctions able to force to take thought any country which is willing to stop transit of Russian gas, says Vice Speaker of the State Duma of the Russian Federation Valery Yazev. And though the experts doubt the prospects of approval of this Russian version of the Energy Charter, its intentions are obvious: Russia threatens to the countries like Ukraine (or first of all, Ukraine) with stricter responsibility. *While the issue of inter-dependence and mutual responsibility of the energy market players in the triangle “producer – transiter – buyer” is not considered as a key one.*

### ***With Whom Ukraine Dined in Brussels and Who Will Pay for That***

Not due to all this but contrary to all this, an international EU-Ukraine conference on modernization of the Ukrainian gas transportation system was held in Brussels on March 23, even though this conference was many times rescheduled on different reasons. The document which was signed as a result of EU-Ukraine conference and which is called declaration is in fact a joint statement signed by the Prime Minister of Ukraine Yulia Tymoshenko, European Commissioner on External Relations and European Neighborhood Policy Benita Ferrero-Waldner, Energy Commissioner Andris Piebalgs, President of the European Investment Bank Philippe Maystadt, First Vice President of EBRD Varel Freeman and World Bank representative Martin Raiser.

This document contains seven key items of Ukraine’s obligations, based on the results of fulfillment of which international investment institutions intend to give funds necessary for reconstruction of the gas transportation system to Ukraine. Today, it is difficult to give the exact number but, in the meantime, specific business projects will be developed according to master plan submitted by the Ukrainian side. Investors have already promised that interest rate on future loans will be as low as possible – Libor + 1%.

As for obligations of the Ukrainian government, the most important issue is item one: *“To ensure independence of operator of the Ukrainian gas transportation system, with respect to its legal and organizational forms...”* With all the loyalty of this wording, the Europeans wish “UkrTransGas” subsidiary (which, in fact, is an operator of the Ukrainian GTS) to be separated from National JSC “NaftoGaz Ukrainy” into an independent company. Why do the Europeans need this?



*First and foremost*, there is an EU directive according to which all European companies must separate gas transit and storage functions from its extraction and sale. In Ukraine today, all these functions are performed by National JSC “NaftoGaz Ukrainy” as a single company, though de-facto “UkrTransGas” subsidiary is a GTS operator. They are fined, they promise to fulfill EU requirement soon and ... everything is repeated all over. But the process has started.

*Secondly*, investors require the money earned by the GTS operator, i.e. “UkrTransGas”, to remain with this enterprise. So, that it would have enough money to repay the loans, to continue its activities, i.e. – to finance independently future repairs and reconstructions.

### ***“UkrTransGas” Autonomy: Pro and Contra Arguments***

It is obvious for Ukraine that in the conditions of systemic crisis it will be difficult to modernize GTS only with own funds, without the loans. Therefore, a decision was taken on involvement in this project of our European partners interested in reliable and uninterrupted supply of blue fuel. Accordingly, National JSC “NaftoGaz Ukrainy” opens the doors for all those willing to take part in this project, first of all, for OJSC "GasProm" and even Japan.

It is a question on increased reliability, effectiveness and commercial attractiveness of transportation routes, decrease of negative impact on environment, minimization of risks in gas supply to the European consumers through the territory of Ukraine.

The following tasks were selected as priorities:

- support of the project technical parameters for the main transit gas pipelines and underground gas storages;
- increase of GTS transit capacity at exit by 60 bn m<sup>3</sup> in case of consent from OJSC "GasProm";
- implementation of modern methods of control over technical condition of the Ukrainian GTS objects, registration of quantity and quality of gas on a real-time and space basis in the territory of Ukraine;
- bringing the normative and technical base of the Ukrainian GTS in compliance with EU requirements.

Implementation of provisions of the declaration signed as a result of the conference will allow National JSC “NaftoGaz Ukrainy” to maintain constantly work of the Ukrainian GTS on the international level of control over volumes and quality of gas. But as the First Deputy Chairman of the Board of National JSC “NaftoGaz Ukrainy” Igor Didenko said: *“We believe that today complete separation of “UkrTransGas” subsidiary from the structure of National JSC “NaftoGaz Ukrainy” is economically inexpedient.* As majority of the European gas holdings,

National JSC “NaftoGaz Ukrainy” is a vertically integrated structure, 100% of shares of which is controlled by the state. Under the current Ukrainian economic conditions, control over the transit operator and storage of gas within National JSC “NaftoGaz Ukrainy” is the most effective and optimal version”.

Moreover, billions of loans were extended to “NaftoGas” on the terms of preservation of the company integrity. And should “UkrTransGas” subsidiary become an independent GTS operator, “NaftoGas” creditors will receive a serious reason for concerns and even, probably, an incentive to require urgently repayment of all debts. It will be difficult for “NaftoGas” to repay all loans simultaneously. And what is then? Application of already familiar to Ukraine international sanctions: arrest of property abroad etc.

Though, the advisor to the Ministry of Fuel and Energy of Ukraine Ivan Varga says that an independent GTS operator is beneficial for Ukraine. Because even with such transit prices (transit rate – USD 1.7 for 1,000 m<sup>3</sup> per 100 km) and gas storage prices, “UkrTransGas” manages to work with 10-15% profitability. How much is it in financial terms? According to short-cut calculations, “UkrTransGas” earns on transit not less than USD 1.7 billion a year, at current rates. Another UAH 5 bn this company earns for transportation to the Ukrainian consumers of approximately 60 bn m<sup>3</sup> of gas in the country, plus at least UAH 0.5 bn – for storage of gas at the effective minimum rates. Should all these funds remain for the company development, it would not need any special loans.

By the way, says I. Varga, "GasProm" itself takes the way of division of functions. In many regions, in particular, in St. Petersburg, functions of gas supplier (transportation) and seller's functions are clearly separated. Moreover, only in this one market there is competition of several one-field enterprises which ensures quality of services and leads to decrease in prices. While here the government simply uses the funds earned by “UkrTransGas” and does not worry about technical condition of GTS and its objects. I. Varga believes that it is not important who owns a GTS operator, especially because the pipes in Ukraine are in state ownership.

Quite frank was also the statement of Marc-Antoine Eyl-Mazegga from the Center of Political Studies of Paris Institute of Political Research (Sciences Po), project manager of Robert Shuman Foundation (Paris). He believes that maintaining functioning of the Ukrainian GTS is important for Ukraine itself, for Russia and for the European Union: even if “Nord Stream” and “South Stream” will be constructed, Ukraine will continue to transport 65-75 bn m<sup>3</sup> of gas a year and will remain the most important transiter of Russian gas. If only “Nord Stream” will be implemented, Ukraine will pump at least 80-90 bn m<sup>3</sup> of gas a year. But as not a single of the new projects has been implemented so far, Ukraine will continue to transport the current annual

volume of gas – 110-120 bn m<sup>3</sup> – at least for the next five years. “Ukrainian GTS is irreplaceable, and they know it in Russia, in Ukraine and in EU countries,” – he mentioned.

*Herewith, the following issues remain the key ones: who will give money and on what terms?* Funds of the private banks can be provided only if there exist government guarantees in case of infrastructure privatization. It will hardly occur because of the financial crisis. International financial institutions, such as the World Bank, European Investment Bank, EBRD or European Commission may give loans. But Ukraine then will have to reform its energy sector – actually, to accelerate the reforms which are necessary for accession to the Agreement on Energy Community, and this is written in the joint declaration. Therefore, this investment event is a nice incentive for acceleration of the process in which all are interested.

So, what should be done taking into account the aforesaid? Of course, the priority is to reform National JSC “NaftoGaz Ukrainy”: increase of parliamentarian control over the company and its affiliated structures, separation of transit activities and activities on extraction and distribution of gas; increase of prices for the public sector of economy and regulated price for gas which is purchased from the state-owned gas extraction enterprise. The necessary conditions are also existence of an independent regulator able to be responsible for energy safety, competition and constant development of the industry; installation of gas meters in all households; freedom of access for private corporations with vast work experience to extraction and production of gas in Ukraine; construction of gas measuring stations on the Ukrainian side of the border with Russia and harmonization of standards with Russia and EU. And finally, it is necessary to create mechanisms which will guarantee transparency of flows at any time, in any place and for all interested parties.

*Actually, all this is stipulated by the Brussels declaration.* The sooner Ukraine will fulfill the requirements for membership in the Agreement on Energy Community and implement EU legislation in the area of competition, the easier it will be for it to open access to underground gas storages for the European distribution companies (for example, through swap transactions) and to make good money on this.

*Undoubtedly, there is a high probability that change of sale point for Russian gas at the Ukrainian-Russian border will be blocked by "GasProm" which is interested in it. After the January gas crisis, Ukraine must regain trust and prove its desire to make reforms.*

Ukraine now received a chance to add one more item to a not very long list in the matter of strengthening of energy safety of the state. Removal of “RosUkrEnergo” and transfer to formula pricing in the area of gas import were very important steps. In addition, the Ukrainian side, until the end of this year, must develop a program for reforming of gas sector and implement it in 2010-2011.

Even if Ukraine is not going to become urgently an EU member (nobody even invites us) but at least has intention to work on equal terms both with EU as the buyer of gas and RF as the exporter of gas, and also to receive income from its geo-political location in Europe, and from transit, it must gradually adjust to the European rules. Especially, as the agreement on Energy Charter was signed and ratified by Ukraine long time ago, unlike Russia. It stipulates practically identical principles of work of the European energy market as those fixed in the Brussels declaration.

Having signed in Brussels the declaration on results of the international conference on modernization of the Ukrainian GTS, the European Union publicly demonstrated an intention to see our country in prospect as an independent player (transiter) in the European energy market. And this means that Russia and "GasProm" will be unable to strengthen its dictate to the European Union and Ukraine in gas policy issues, in particular, with respect to purchase prices and transit rates. Therefore, having started a closer cooperation with Ukraine, the European Union let everybody see whom it supported during the January Ukrainian-Russian gas conflict, and that it is not going to allow the same in future. How fruitful will be cooperation between Ukraine and EU, depends on both parties. But how unambiguous will be EU decision in support of Ukraine – this is questionable so far.

In the Brussels declaration, there is no section on liabilities of the European Commission or investors. But in the section “Further Steps”, forms of cooperation between all the signatories to the declaration are outlined. First and foremost, this is establishment within National JSC “NaftoGaz Ukrainy” of the Technical Coordination Group. (It is being established today).

This group must develop, on the basis of the master plan, a business plan for modernization measures; to monitor works on GTS modernization; to assist in development of measures for modernization plan financing by the International and Ukrainian creditors and possible donors.

The European Commission is prepared to consider a possibility for rendering assistance to the government of Ukraine in reformation of its gas market. The Ministry of Fuel and Energy, together with other related Ministries and government institutions and companies, is already considering options for reformation of the Ukrainian gas market. All projects will undergo an expert evaluation. And already according to its results, if necessary, the European Commission will provide also financial assistance. Main hope is for investors.

The Brussels declaration allows "GasProm" also to take part in financing of the Ukrainian GTS modernization. It says, in particular: “Other partners who intend to provide grants and loans for modernization of the Ukrainian GTS are invited to submit to the Technical Coordination Group detailed information on their readiness and possible level of financial participation”.

The issue of increase of transit capacity of the Ukrainian GTS and possibility of gas purchase by the European gas consumers on the Eastern border of Ukraine were only a couple in a set of proposals of the Ukrainian side offered for consideration by the European experts. And this has seriously discomfited Russia.

First, it was expected that the indicated issues will be discussed in a tri-lateral format. But until last moment, neither National JSC “NaftoGaz Ukrainy” nor the conference organizers had official confirmation that representatives of RF energy sector will participate in it. Demarche of the Russian delegation which left the conference room in Brussels was expected and foreseeable. In fact, it was an attempt to impose again on the European community an idea of Ukraine’s inability to reach agreement, to discredit it again as a reliable business partner.

First reaction of the Russian Prime Minister V. Putin rather reminded of a child’s hysterics when a favorite toy car is taken away. And there was a reason for this. In particular, *in case of implementation of the Brussels declaration provisions, Russia loses total control over transit of Russian gas through the Ukrainian territory. RF will have to consider Ukraine as a full-fledged transit participant. I.e. the agreements for transit will be concluded in a tri-lateral format, and the European gas consumers will receive gas on the Eastern border of Ukraine.*

Moreover, should EU continue its movement towards participation in modernization of the Ukrainian GTS, Russia will not only lose its political influence on Ukraine, but also incur significant economic losses. As of today, construction of by-passing gas pipelines “Nord Stream” and “South Stream” requires almost USD 45 billion. At the same time, proposal of the Ukrainian side is as follows: to invest in modernization of the existing Ukrainian GTS USD 5.5 billion to increase transit capacity by 60 billion m<sup>3</sup> (from current USD 140 billion to 200 m<sup>3</sup> a year).

This layout is not simply a geopolitical knock-down for the Russian management in post-Soviet space, but a full knock-out with practically complete loss of ability to influence Europe through the gas valve. That is why the Russians reminded to the Europeans not incidentally that they are a big consumer of their goods. In particular, "GasProm" is the largest buyer of equipment in Europe. For instance, one German company is very proud with the Russian multi-million order for construction of underwater part of “Nord Stream” gas pipeline.

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As for Ukraine, it is time to think about review of gas agreements of 19 January 2009 at least, for 2010. And in June new government will be elected in Europe, and new persons mean new opportunities for Europe, for Ukraine, and for Russia. Who and how will exercise these opportunities? So that it will not be like five-six years ago when Ukraine and Russia first

established a consortium to manage and develop the Ukrainian GTS, and then invited Germany to join the company. The then German Ambassador to Ukraine Mr. Stüdemann said then in his interview that “Germany will not sit at the table at which others have already dined”. On March 23, Ukraine dined with EU.

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## **GEOPOLITICAL ASPECT OF RUSSIA’S ENERGY POLICY IN RELATIONS WITH UKRAINE AND THE EU**

The main event of the first quarter of 2009 in relations between the EU and Ukraine was the gas war proclaimed by Russia in consequence of which not only Ukraine but also the European Union countries suffered. Consequences of this war were logically continued in actions of all three parties during the last months of this year.

It is evident that this gas war will make the European Union reconsider its attitude towards Russia, as well as realize importance of Ukraine in ensuring the security of the EU. It is evident that change of approaches in relations with Russia and Ukraine seems to be quite a hard task for the European Union. As the EU used to consider Russia as a strategic partner and a stable supplier of energy products for Europe, as well as a key factor of European security. Such priority of Russia in the European Union’s foreign policy always assigned to Ukraine a small part which is subordinate to Russian interests. Brussels has already used to explain for itself those difficult problems that emerged in relations with Russia either by Ukraine’s fault or by internal Ukrainian and Russian disputes which were out of all relation to the EU countries.

“Gas war” showed that such traditional stereotyped approach of Europeans is dangerous, first of all, for their own sakes. The European Union’s short views and inability to separate Russia’s commercial interests from its political and geopolitical interests clearly showed the EU’s inability to protect its own energy security from the new challenges provoked by Russian foreign policy.

As the “gas conflict” faced by both Ukraine and the EU in relations with Russia is taking place not for the first time. In 2006 Russia has already stopped exports of gas via Ukraine. However, as an observer of Radio Free Europe Ulrich Speck mentioned, the European Union had made no adequate

conclusions from this crisis<sup>2</sup>. As a consequence, vulnerable points of the EU's energy security are the most important three positions.

**First.** Lack of a common European energy policy. This enables Russia to conclude separate agreements with some EU countries, making them compete with each other for Russian gas.

**Second.** Giving preferences to some EU countries for their political loyalty, Russia splits the unity of the European Union, putting some of its members into political dependence. "Europe is vulnerable to political pressure as long as gas markets in the European states remain insufficiently interconnected. The more European gas markets are connected, the reasoning goes, the less individual countries would be threatened by supply disruptions, because neighboring countries could immediately help out when shortages occur. A single, competitive gas market would help to depoliticize gas"<sup>3</sup>.

**Third.** The European Union's practice to rely on Russia in its provision with gas. It is evident that for ensuring its energy security the EU should diversify the sources and routes for energy products supply.

Certainly, these EU's vulnerable points were taken into account fully in realization of Russia's energy strategy. The Kremlin also reckoned on the European Union's bias in relation to Russia and, accordingly, it was confident in success of its information campaign on discredit of Ukraine as an unreliable supplier of energy products before the beginning of gas war. "A lobbying firm in Brussels was hired by Moscow to reassure Continentals about the security of their supplies - at least until yesterday - and pin the blame on Ukraine's refusal to pay a "market price" for natural gas and keep up payments. The Russians even created a Web site - [www.gazpromukrainefacts.com](http://www.gazpromukrainefacts.com) - that yesterday noted that, "Ukraine is responsible for everything that has happened"<sup>4</sup>.

Moscow expected that the Europeans would perceive the gas conflict as a commercial dispute that emerged through the fault of Ukraine. Russia in its gas war against Ukraine imposed three typical stereotypes on Europe and the whole international community.

1. Ukraine steals gas reserved for Europe.
2. Dispute between Ukraine and Russia has a commercial character and is not politically charged as it is related to agreement of price for gas which Ukraine does not want to pay.
3. In point of fact "gas conflict" between Ukraine and Russia is a dispute of Ukrainian oligarchs for control over the gas pipe.

Which is a deal of truth in these ideological clichés? To what degree did such accusations justify Russia's actions in gas conflict?

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<sup>2</sup> Ulrich Speck. European Union. Different lessons from the gas crisis // Radio Liberty. 10.02.2009

<sup>3</sup> Ibidem.

<sup>4</sup> *The Wall Street Journal: The Winter Gas War*. Segodnya, January 8, 2009.

Regarding accusations in gas stealing, the monitoring initiated by representatives of the EU countries during the gas war testified their falseness. During 2006-2009 Ukraine took from the gas pipeline system only technical gas needed to transport Russian gas to Europe and gas for Eastern regions of Ukraine freighted in Russia.

A thesis that the conflict was not politically charged and had a commercial character and, therefore, justified Russia's actions was accepted by the EU countries at once. Prime minister of the Czech Republic Mirek Topolánek, the presidency of which coincided with the beginning of gas crisis, mentioned at the beginning of this conflict that this was a commercial dispute and the EU would not take part in settlement of this dispute which was a bilateral one – between Ukraine and Russia. By the way, such comment was also supported by other EU Central and Eastern European countries.

Official representatives of the European Commission, trying to reduce tension in this issue, stated that the gas dispute did not pose a threat for European consumers at the time. European politicians emphasize that the existing problem does not affect the European consumers due to available rather large volumes of gas reserves. However, such statements turned out to be too optimistic. Six European countries reported a halt in gas supplies while five others saw significant reductions of volumes of imported fuel. Tens of thousands of people were left without heat, including two mid-sized cities in Bulgaria. In the USA, heating oil prices jumped 3.3% on expectations that Europeans would switch from natural gas to warm their homes.

In the meantime V. Putin explained to their colleagues that “the European partners are becoming hostages of the dispute between Russia and Ukraine. But this dispute over supplies, conditions and prices for natural gas supplies is for Ukraine itself”. “Nobody, no one transit country has a right to take advantage of its transit status, speculate on it in order to make the European consumers hostages”, - he resented, reminding that there was a transit contract which remained in force till 2013 and annexes to it which were in effect till December 31, 2010<sup>5</sup>.

This meant for Europeans that Ukraine did not pay to Russia a market price for Russian gas consumed by it as the great majority of Gazprom's clients did. In fact, where there is one great monopolist Gazprom and long-term contracts, there is no market price for gas in practice. Gazprom by itself can establish prices for every country<sup>6</sup>. In Europe price for gas is determined on the basis of formulas which are formed proceeding from the price for alternative kinds of energy resources in every certain country (as a rule, these are the power-generating coal and fuel oil). In fact, considering the sharp fall in prices for oil and other kinds of energy resources in the second half of 2008, gas to Europe is supplied by Gazprom at the price of about \$ 250-300 per one thousand cubic meters of gas, on the basis of long-term contracts. And this includes its transfer to European consumers. That is why

<sup>5</sup> Putin is ready to burn all treaties with Ukraine. TSN.ua. Moscow, January 14, 17:27.

<sup>6</sup> Ukraine left Europe without additional cubic meters. 16:14, 06.01.2009 VLASTI.NET / Ukraine, Economy /



Russia categorically denied the formula formation of prices for gas for supplies to Ukraine and involvement of Western experts as intermediaries for discussion of the mechanism of formation of prices for gas supplies to Ukraine. It wants to use some “average market price” declared by Russia itself in Europe<sup>7</sup>. For Ukraine Gazprom established an initial price in \$ 450 per one thousand cubic meters, given the fact that the distance of transportation of gas to Europe is considerably larger than to Ukraine.

A statement that in fact the “gas conflict” is a struggle of Ukrainian oligarchs for control over the pipe has been justified in some degree since the moment when Ukraine agreed to delegate the intermediary functions to the commercial structure “RosUkrEnergo” in 2006, taking out the direct subjects of these relations “Naftogaz” of Ukraine and Gazprom from direct operations. In such a way a “non-transparent” – many assume deeply corrupt – structure for transfer of payments for the transit of Gazprom gas emerged. Its (Ukraine’s – author) fractious leaders resisted efforts to make the energy market transparent or wean its economy off relatively cheap Russian natural gas<sup>8</sup>.

Competing political forces in Ukraine were really interested in control over transportation of Russian gas to Europe, as the non-transparent schemes of calculations for transportation and sale of Russian gas gave large shadow financial resources for election campaigns and satisfaction of needs of financial oligarchic groupings which supported one or the other of political parties in the country. It is obvious that it was important for Y. Tymoshenko to liquidate “RosUkrEnergo”, as one of its founders D. Firtash and Y. Boyko could sponsor V. Yanukovich at the scheduled presidential elections in Ukraine. It is obvious that those political forces which relied upon for financial support from D. Firtash tried not to allow Y. Tymoshenko to eliminate this structure from the gas market. Probably, such dispute was one of the direct prerequisites of outbreak of gas war between Ukraine and Russia at the very beginning of 2009. In particular, insinuating this reason, an official representative of Gazprom Sergiy Kupriyanov made a statement: “We get the impression that the problems which have emerged in relations in the gas sphere now are connected from Ukrainian side not with the commercial issues, not with the agreement of prices and tariffs, but with the fact that there are such political forces in Ukraine which are trying to make us preserve the intermediary structures between Gazprom and Naftogaz in every way and with any expenses”, - Kupriyanov said. “We consider that these internal Ukrainian disputes under no circumstances should influence upon reliability of transit via Ukraine of Russian gas for European consumers, what, unfortunately, took place”, - he added<sup>9</sup>. Certainly, the Kremlin that had a monopoly over Gazprom could not be satisfied by such dispute concerning the gas pipe among Ukrainian politicians – there was nobody to make arrangements with. However, it cannot be affirmed that commercial disputes between Russian and Ukrainian politicians and oligarchs were

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<sup>7</sup> Borys Kushniruk. How to overcome “Putin’s bluff”. [10.01.2009 11:58].

<sup>8</sup> *The Wall Street Journal: The Winter Gas War*. Segodnya, January 8, 2009.

<sup>9</sup> Was the gas war begun because of “RosUkrEnergo”? Segodnya.ua. Thursday, January 8, 2009 11:03.

the main reason of gas war. The main reason is in Russia's geopolitical interests where an energy factor is one of important instruments of their realization.

Russia also used its gas lever as an important instrument of the policy of force before this gas war. First it felt its effectiveness in negotiations with Ukraine in 1997 during signing the Agreement between the Russian Federation and Ukraine about the status and conditions of Russia's Black Sea Fleet presence in Ukraine. Then Russia agreed to write off 2 billion of Ukraine's gas debt in exchange for leasing by Russian Fleet of the basing system in the Crimea till 2017. In a greater degree, this was a debt of private intermediary structures which was later set off as a national debt.

Russia began to use this geopolitical instrument more frequently as a factor of maintaining the post-Soviet countries in the sphere of Russian influence and their containment on the way of European and Euro-Atlantic integration. Latvia was the first country which felt pressured in energy sphere by Russia for its Euro-Atlantic integration aspirations, when on the 1<sup>st</sup> of January 2003 the Russian oil transporting monopoly "Transneft" stopped oil transporting. Later in 2004, having stopped gas supplies to Belarus, Russia was able to take control over the Belarusian gas pipeline system.

1999 may be considered the beginning of use of the energy factor as a means of containment of Ukraine on the way of European and Euro-Atlantic integration, when after L. Kuchma's victory at the presidential elections the foreign policy course of Ukraine was directed towards the USA and Europe. The Orange Revolution in Ukraine was a real shock for Russia and testified a total failure of its foreign policy. Since then the Kremlin has not refused from the intentions to overthrow the democratic regime in Ukraine, openly declaring that it is not willing to consider this country as an independent and sovereign state<sup>10</sup>.

Under the conditions of sudden rise of Ukraine's international image after the Orange Revolution Moscow did not dare to use the frankly aggressive methods of pressure. And in this context the non-transparency of intermediary schemes in Ukrainian – Russian gas relations proved to be quite "useful". High officials which had taken their positions in high structures of power under the flags of both Orange and white-blue colors did not protest against these schemes. Inexpertness and corruptness of Ukrainian authorities became an important channel of destruction of Ukrainian national identity and incorporation of Ukrainian political class in Russia's business and political interests. "All Ukrainian presidents, heads of governments and heads of Naftogaz (although it should be mentioned that the same situation is also observed in Russia) have considered the gas pipeline system and trade in gas as a source of personal gain and gain for certain people. Accordingly, the whole system of functioning of Ukraine's gas industry is so non-transparent and corrupted"<sup>11</sup>.

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<sup>10</sup> Financial Times: Last Season of the Theatre of Greed and Power // Korrespondent, - January 6. - 2009.

<sup>11</sup> Borys Kushniruk. How to overcome "Putin's bluff". [10.01.2009 11:58].

It is obvious that it was possible to stop this channel of destruction of Ukrainian national identity and loss of independence by the country only through the liquidation of shadow intermediary schemes. In addition, due to the presence of commercial intermediary “RosUkrEnergo” at the Ukrainian gas market, Russian Gazprom had direct access to Ukraine’s internal market and an opportunity to establish its control over the part of internal networks of gas distribution and supply on its territory. The other challenge was that the basic principles for signing the long-term contracts on Russian gas supplies to Ukraine had not been defined. For this purpose the Prime Minister of Ukraine Y. Tymoshenko made visits to the Russian Federation on the 20<sup>th</sup>-21<sup>st</sup> of February and 28<sup>th</sup> of June 2008. During the visits most of the focus was on the issues of two countries’ cooperation in energy sphere, NATO problematics and Russian Black Sea Fleet’s temporary stationing on Ukraine’s territory.

Upon results of the meeting of Chairs of Governments of Ukraine and Russia on October 2, 2008 in Moscow, a Memorandum on cooperation in gas area was signed, which will be laid as a basis of a strategy of supplying Ukraine with gas. During a meeting on November 14, 2008 in Chisinau, as part of participation in the meeting of the Council of Heads of Governments of CIS member-countries, Y.Timoshenko and V.Putin discussed Ukraine-Russia cooperation in the energy sector and ways of interaction between two states in order to withstand the global financial crisis.

For Y.Timoshenko as the Prime-Minister of Ukraine, it was crucial to settle the “gas conflict”, negotiate an acceptable formula for gas payments and exclude from the scheme such gas intermediary as RosUkrEnergo. As for political interests, as observers note, “realizing the importance of the pro-Russian constituents in the South-Eastern regions of Ukraine, Y.Timoshenko has promised to Moscow enough to feel herself comfortable while counting on, at least, friendly, attitude of the Kremlin”<sup>12</sup>.

Obviously, Y.Timoshenko was reluctant to strain relations with Russia, counting on fulfillment of arrangements with the Russia’s Prime-Minister V.Putin on gas supplies to Ukraine, which she had reached during her official visit to Moscow on the eve of the Russia-Georgia war. Nevertheless, such steps have appeared insufficient to anticipate occurrence of gas war between Ukraine and Russia at the beginning of 2009. The reasons of sharp reduction of ability of Ukraine to agree with Russia consisted in change of the nature of Russian state. Ukrainian politicians did not wish to consider that.

From 2004 Russian leaders faced a need not only to change its foreign policy strategies, but to modernize Russian statehood itself. The last four years (2004-2008) became a period of such modernization. As before, in general its meaning came to finding up-to-date necessary correlations between political authority and property. During Yeltsyn’s period, things moved from the state authority to property, meaning that if one had state authority, he/she had access to privatization of the state property. In the first period of V. Putin’s government (2000-2004) this movement reversed: from private property to the state authority, and meant establishment of state control over property. In the

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<sup>12</sup> Alla Yeryomenko. On political gas and gas policy. //Zerkalo Nedeli. - 2008. -№ 25 (704). July 5 — 11

second period, V. Putin decided *to unite private property with the state authority*, to create a type of symbiosis of authority and property, to unite them into one political and economic institute, which Russian political scientists afterwards called the “*state-corporation*”.

The state-corporation represents a political regime, where we can see the existence of a monopoly for political power as well as for private property. Business is subordinated to political interests, and can be used as a political and economic resource at the same time. Due to this, Russian authority can mobilize and concentrate all available material and economic resources in its hands, and, also, use them for the realization of internal as well as foreign political interests. In this way, Russian business becomes a part of politics. At the same time, public administration of the country is formed by rules of business management. Business management rules become a part of public administration. This newly adopted Russian type of the state-corporation is similar to the twofaced Janus, when, disguised as business, the Russian state can capture through private corporations all segments of another country’s economy under conditions of private business and market rules, and to turn them into a part of Russian state property.

“Gazprom” became a prototype of such a state-corporation for V. Putin. As V. Portnikov, the famous journalist wrote: “Russia of Putin’s era turned from a state into a corporation, and “Gazprom” became a state. This is the state, which gradually defends its interests in such way, in general, as countries, but not corporations, usually do, using the whole Russian machine (of public administration, *author*). Russian interests are often guided by the corporate considerations, as, for example, “Gazprom’s”. The state and corporation exchanged their roles”<sup>13</sup>. Following “Gazprom” template, from 2004 to 2008 V. Putin built large Russian state holdings in all leading segments of the economy, and tied them in one corporation - The United Administrative State Company.

The new model of the Russian state was asking, hence, for a new conceptual framing of its foreign policy. Key provisions of the concept of this foreign policy were embodied in the so-called *Medvedev Doctrine*. The foreign policy implications of the Doctrine may be set forth in a few statements. The United States are losing their central position, and therefore, their dominating influence in the world. As the system of international relations begins to disintegrate, the monopolar world is transforming into a multipolar world, as a result of which four to five global leaders are likely to emerge, one of which should be Russia with its own regional sphere of influence. This situation opens before Russia a window of opportunities to revise outcomes of the collapse of the USSR, revisit results of the cold war and get reinstated as the world’s superpower. Russia’s sphere of dominance will be the whole Eurasia, which will include Europe. This high-flying goal shall be achieved in two stages. First stage includes restoration of Russia statehood on the post-Soviet territory. At the second

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<sup>13</sup> Vitaliy Portnikov. Why Medvedev? – K.:»Samlit-Book», 2008. – p.39-40

stage Russia will abandon its defensive stances and launch geopolitical counter-offensive on Europe. Global financial crisis will contribute to rapid weakening of the West.

In opinion of Russian authors of the concept this global financial and economic crisis is bound to end up in the profound changes of the existing world organization. *Enfeebled by the crisis, the West will be forced to abandon the distant periphery and reduce its presence everywhere.* “This is bound to happen with America. Inside America and European Union, the respective weakening may be almost unnoticeable by the naked eye, however, somewhere in Georgia it will immediately become very obvious. And once it begins to happen, as soon as the Russian authorities are 100% sure that in no way America is able to come to Georgia’s rescue, Russia will begin to prepare a war with Georgia, and not only with Georgia. There will be no doubts and no debates, since the only force restraining Russia is America only and no one else”<sup>14</sup>. And we saw that these predictions were fully realized in August 2008.

Further, accents of the new Russian foreign policy doctrine presume that in circumstances of such enfeeblement of the West, Russia may capture the whole of Europe. “Europe will have no chance to preserve its sovereignty in the absence of American aid. Today’s Europe lacks even the will to resist. It is unable to fight anyone, any time and in any circumstances”<sup>15</sup>. *If this is the scenario, Russia has to help Germany and France to put US out of Europe and take over leadership and dominance in the European continent.* This campaign to the West opens up possibilities to integrate into the Russian space not only the Central and Eastern part of Europe, as the Soviet Union had once managed to do as a result of the WWII, but the entire European continent. However, first of all, Russia must regain from the West or pick up, if the latter withdraws, **the European part of the Post-Soviet terrain**. This primarily refers to Ukraine.

So, this global geopolitical context, as well as the new type of the Russian state-corporation, brings forward the need to introduce a new model of relationship with Ukraine, which may be called a **restoration model**. Main goal of this model must be, obviously, to arrange things inside Ukraine *in line with the Russian perceptions of the “right” political, social and economic life styles, as well as the state order.*

Judging from the nature of this Russian state-corporation, the whole foreign policy of Russia will imply the **absorption of political power and ownership** in Ukraine. Due to this two-pronged goal, it is very difficult to detach economic objectives of Russia’s foreign policy from purely political.

However, **in the economic area** objectives are the following:

- gaining control over Ukraine’s gas transit system, of its internal infrastructure and national gas market;

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<sup>14</sup> Mikhail Yuryev. The natural model of the state structure for Russians is a combination of ideocracy and imperial paternalism //Russian state: yesterday, today and tomorrow . - p. 176-177.

<sup>15</sup> Ibid. – p. 174-175.

- taking over ownership of the key segments of Ukrainian economy, its export-oriented, high-tech and machine building industries;
- setting up control over the country's banking and financial systems;
- assist Russian businesses in obtaining preferences.

To implement these objectives, Russia intends to use a mechanism of action and resources of the state-corporation. Taking advantage of market mechanisms and openness of Ukrainian economy, Russia may begin purchasing stock of strategically important businesses or seize them for debt.

So Russia uses gas war for bankruptcy of National JSC "NaftoGaz Ukrainy" so that Ukraine has been compelled to hand over gas-transport system to «Gazprom». Such Ukrainian businesses, which will be passed on to Russian businesses, in due course will become a part of Russia's government ownership.

Such economic expansion will have direct adverse political effects for Ukraine. According to magazine "Expert": 'political class in Ukraine in conditions of Russian economic expansion and liberalization of the national economy is gradually deprived of strong levers of influence. It will be very difficult for a disarmed state to resist such expansion given the on-going political crisis.<sup>16</sup> In other words, if this tendency persists, Ukrainian political class will be either incorporated into Russian political interests by means of inclusion into Russia's financial and political holdings or will be doomed to marginalization and full loss of political power in the country.

Gas war with Ukraine by its geopolitical orientation is very similar to the war launched by Russia against Georgia in August 2008. But it uses other violent methods in relation to Ukraine the main of which is, certainly, the gas blockade. Speaking about the adequacy of these methods, they were quite adequate because, first of all, the gas war was launched in winter. This is a period when there is the greatest demand for heat and, consequently, for gas. Secondly, there is a financial crisis, a severe economic crisis in Ukraine. When you raise the price up to 450 dollars per one thousand cubic meters of gas, then the whole financial system and economic system of Ukraine may collapse. And the whole 16-billion IMF credit granted to Ukraine will be paid to Russia for gas at this price. So, this is the issue of independence and state sovereignty of Ukraine. The scenario seemed to be quite predictable, when the residents of Ukraine's Eastern regions cold by reason of the halt in Russian gas supplies would come to Kyiv and overthrow the Ukrainian government, giving the pro-Russian oriented opposition a chance to take power.

Obviously, the political situation is also very favorable for such gas war, as Ukrainian authorities demonstrated the internal conflict very "successfully". Both the President and the Prime Minister convinced us that they could not make arrangements and they would never unite for the national interests of Ukraine. They also convinced Russia of this. However, another factor shouldn't

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<sup>16</sup> Oleg Khrabriy. Syndrome of Irreplaceability// Expert, - 2007. - № 20. – p.58.

be forgotten – this is the world financial crisis which also had a strong impact on Russia. Today the Russian gold holdings are destroyed very rapidly. Russia needs money to maintain its financial system and economy, and it is absolutely clear. However, we see that the geopolitical interests, unfortunately, dominate.

For Russian authorities the gas conflict is a method of establishing control over Ukraine's gas pipeline system and strengthening its position in the international arena. Monopolization of the gas transmission sphere for Russian foreign policy has been one of the priorities since the early 90's. Since then a few unsuccessful attempts to establish control over the Ukrainian gas corridor were made, but this time the Russian authorities have decided to make the financial – economic and political crises and winter their “allies”. Through this conflict Russia wanted to show Ukraine as an unreliable gas transporter to the European Union, and consequently, to demonstrate the necessity for its control over its gas transmission corridor.

Establishing its control over the Ukrainian gas pipeline system, Russia intends to considerably strengthen its geopolitical influence upon the whole Europe. As through the Ukrainian gas transmission corridor about 80% of Russian gas is delivered to the European market. As the Wall Street Journal mentions: “The Kremlin's goals in Ukraine are transparent. Kiev's support for Georgia in the August war, and its ambitions to join the EU and NATO, is a thorn in the bear's paw. In Europe, Russia wants to reassert itself as the dominant power in the East, feared if not respected”<sup>11</sup>.

In particular, the EU positions concerning Russia were ambiguous in the gas conflict. There are some countries which support Russia's actions and are willing to come to terms with Russia (Germany, France, Italy) and which are willing to give up Ukraine's interests for the benefit of Russia's interests. We saw this in Bucharest and on other examples. But there are some countries which do not agree to play such game with Russia. These are the young democracies of the Central European countries which do not agree with such EU position. If Russia can make arrangements with “Old Europe”, then it is very difficult to make arrangements with these “new” countries which, by the way, support Ukraine's NATO and the EU membership: they have their own principles, and the historical experience taught them what such geopolitical game was worth. So, Russia demonstrated power by this gas conflict: if the Central European countries do not want to come to terms with Russia, they may become cold. Thus, the gas conflict turned out to be a conflict not only against Ukraine, but also against the Central European countries. It is obvious that for strengthening its influence upon Europe, Russia considers the European Union's vulnerable points, such as dependence on Russian energy products and lack of unity of the EU countries' positions concerning the common energy policy and foreign policy in relations with Russia. In its strategy Russia prefers bilateral relations with the leading EU countries such as Italy, Germany and France, ignoring the interests of

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<sup>11</sup> *The Wall Street Journal: The Winter Gas War*. Segodnya, January 8, 2009.

other EU countries. So, the Russian policy concerning the EU countries preconditions the absence of harmonized policy of European countries in relation to Russia itself.

Lack of a unified consolidated position concerning Russia makes the EU vulnerable to the Russian geopolitical attack. Demonstration of the absence of the European Union's harmonized policy in relation to Russia is the existence of two fundamentally different approaches. According to one of them, Russia is a threat that should be gently restrained. It is followed by mainly the Central and Eastern European countries – the new EU members. While the old EU members – the Western European countries – consider Russia as a potential partner which should be integrated into the European system.

Although all EU countries tend to the opinion that the main form of relations should be cooperation, they understand the character and essence of these relations in different ways. So, Germany, France and Italy develop their strategic partnership with Russia contrary to the principles of the EU common foreign policy, relying on it as on a potential ally in opposing the USA policy. Greece and Cyprus are considered to be the “Trojan horses” in the EU which support Russia the most consistently. Austria, Belgium, Finland, Slovakia and Portugal are considered to be the friendly pragmatists whose relations with Russia are not as close as in case of the first two groups of EU countries, but they are directed to developing the economic cooperation. Another 9 countries, including the Czech Republic, Latvia, Denmark, Sweden and Great Britain relate to Russia very distantly, adequately assessing its foreign policy and those threats generated by it for the European security. Finally, Poland, Lithuania and Estonia try to openly oppose Russia's geopolitical attack on Europe.

The EU countries following the first approach consider that ensuring the energy security is not in the sources of energy products, but in transport routes. So, in their opinion, it was necessary to protect the large European consumers from Eastern European transport routes, including the Ukrainian one. Therefore, the main priority for these countries was the construction of transit routes round about Ukraine which will deliver Russian gas directly to consumers in Central and Western Europe. Germany and Italy are in charge of the group of these countries. Jointly with the Russian state monopolist “Gazprom”, they participate in implementation of two projects – “Northern Stream” and “Southern Stream”. The greatest progress was achieved in implementation of the “Northern Stream” project which is to join Russia and Germany directly on the bottom of the Baltic Sea. “Southern Stream” should join Russia with the Southern Europe, Italy and Greece, on the bottom of the Black Sea. The “Northern Stream” project stipulates participation of two German companies, BASF/Wintershell and EON each of which has 20%, and “Gazprom” which has the most part – 51%. The other 9% belong to the Dutch company “Gasuni”. And the former Chancellor of Germany



Gerhard Schröder is in charge of this project. “Southern Stream” was divided in equal shares between “Gazprom” and Italian ENI.

Poland, Lithuania and Estonia jointly with other Eastern European countries oppose the “Northern stream”. They consider that it is an attempt to divide Europe. Russia will have an opportunity to influence upon different European countries on a selective basis, excluding the countries which conduct their policy beyond the scope of Russian geopolitical interests. Some experts mention the doubtful economic expediency and environmental threat of this project. Now Sweden carries out its environment impact assessment, and Finland promised to carry it out next year. The pipeline is to be laid through the territorial waters of these countries. In Moscow these steps are perceived very negatively. The Prime Minister Putin even made a statement that “Europeans should decide whether they need this gas pipeline or not”.

Considering such variety of positions and interests of the EU countries, Russia launches the geopolitical attack on Europe, using its energy strategy in two strategic directions – northern and southern – building the “Northern Stream” and “Southern Stream” pipelines. “Northern Stream” should ensure Germany’s energy security through the exclusion from the transport chain of the transit countries, including Ukraine. However, it is necessary to remember about the primacy of Russia’s geopolitical interests over the commercial interests. So, the “Northern Stream” is likely to reflect the *geopolitical axis “Moscow – Berlin”*. Regarding the “Southern Stream”, as the famous Hungarian economic expert on energy issues Anita Orbán considers, “it will actually increase the dependence on Russia of the whole region of Southern and Eastern Europe – Bulgaria, Romania, Serbia, Hungary and neighboring countries – for an indefinite term, for several decades”<sup>12</sup>.

But, as the events of the last month of the first quarter of 2009 showed, the EU is not going to capitulate before Russia. Realizing the threat for the EU and Ukraine’s energy security from Russia, the Brussels Declaration on modernization of Ukraine’s gas transit system was signed by the Prime Minister Yuliya Tymoshenko and the President of the European Commission José Manuel Barroso on the 23<sup>rd</sup> of March 2009.

Although the modernization of Ukraine’s gas transit system corresponds to Russia’s economic interests as it provides stable supplies of Russian gas to Europe, as well as constant currency incoming to the Russian state budget, Moscow reacted to its signing in a hysterical manner. Why did it react in such a manner? It is clear. The matter is that the economic issue is not so important for Russia. As it was mentioned, the most important problem for Russian foreign policy is a status problem, a problem of improving its international status, return of the status of world power. As a matter of fact, it was the reason of the conflict in the Caucasus last year; it gave occasion to the “gas war”. Certainly, implementation of this declaration will disarm the Russian Federation in its effort to achieve political

<sup>12</sup> Mar’yana Drach. Russia’s energy projects as a continuation of foreign policy / Radio Liberty, 11.02.2009

dominance in Europe. And this will finally improve the climate of our bilateral relations with Russia itself.

Despite all disadvantages of the Brussels document, its signing may be rightfully considered the strategic victory of Ukraine and the EU. As this declaration is not just a technical document, it is a document of political character. Speaking the language of diplomacy, it is a framework document which stipulates no specific commitments, figures, definite volumes and dates. In diplomatic and foreign policy practice, such documents fix the principles on which the future mutual relations are developed.

In fact, this is a constitution of new relations between the parties, and according to this constitution the specific agreements with specific commitments, definite volumes and dates, as well as with specific responsibility are written later if these volumes and dates are violated. For this purpose a broad range of agreements is elaborated on the basis of this treaty, but these agreements will have only the tactical meaning. This document has the strategic importance. Why? In principle, leaving aside the viewpoint of common sense, the Declaration is profitable for all gas market participants in economic aspect.

The logic is very simple. The crisis is everywhere, nobody has money, and for what does one need to spend money on doubtful projects? Building of the “Southern Stream” is a doubtful project at this stage – there are more questions than answers there. According to minimal calculations, the cost of this project will reach about EUR 25 billion. The cost of “Northern Stream”, according to the same previous calculations, will account for about EUR 20 billion, while the cost of modernization of Ukraine’s gas transit system will not exceed EUR 6 billion, depending on its depth. Even if the “Northern Stream” is built, from the point of view of filling it with gas it does not compensate the transporting of Russian gas through the Ukrainian gas transit system. Therefore, from the viewpoint of common sense, for what is it necessary to spend big money which no one has and which should be found somewhere? So, it is better to modernize the existing transit system, having invested much less money, and to have stable supplies. In this case Russia will have a stable gas supplier to Europe, and the Europeans will also have such a stable and understandable transiter. The issue of this declaration is not so much in credits, as in a fundamentally new mechanism of control over the transit of this gas. And this is a more principal decision from political point of view, than the definite credits and volumes of these credits.

So, what will the European Union win from realization of the Brussels Declaration?

**First.** The European Union gets a stable and reliable transiter.

**Second.** The European Union saves money on building of rather doubtful projects round about Ukraine.

*Third.* The conflict factor between Ukraine and Russia is removed in which the European Union (in this gas issue) is its hostage. Ukraine is excluded from this conflict situation, because the European Union will buy gas on the Eastern border of Ukraine and “Ukrtransgaz” will deal with European but not with Russian gas.

The very important moment, and this is also our strategic victory, is that we managed to substitute Berlin by Brussels in this scheme, and it is very important. This Putin’s hysterics was related, first of all, to the fact that the bilateral format, rather, trilateral, is excluded from this scheme, where, so to say, Ukraine is as a “portionless daughter”. Putin, typically, offered to return to the old trilateral Ukrainian-Russian-German consortium. It is clear that in case of renewal of this consortium, and considering the bias of German “Rurgaz” towards Russian “Gazprom”, this gas transmission system will be simply taken away from Ukraine.

Implementation of the Brussels Declaration will make Ukraine involved into the European energy system. And this is our real European integration step, not declarative, but the real step of implementation of that strategic foreign policy course which was chosen by Ukraine. As the European officials declared, this was the first step in renewing the confidence in Ukraine.

The last one is very important. The European Union considers that Ukraine is a problem country not from an economic point of view and not because it has an outdated gas transmission system. By the way, it is even more outdated in Russia. Ukraine is a problem country from political point of view, because this permanent political conflict which is observed in Ukraine so much damaged our image both in the European Union and in the West so that Ukraine is considered the greatest source of instability in Europe. Thus, renewing the confidence is such a step for us which can actually change our image and improve the climate in Europe concerning Ukraine. It will enable us to make real progress in European and Euro-Atlantic directions.

In political aspect signing of the Brussels Declaration is a rather strong step of the government and personally of Yuliya Tymoshenko, as well as of Ukraine and the EU in general. This Memorandum opens a range of opportunities both for Ukraine and the EU. And the European Union has already begun to realize them. On the 22<sup>nd</sup> of April 2009 the European Parliament approved the so-called “Third energy package” – the plan on liberalization of Europe’s energy market. It fully corresponds to the Brussels Declaration on modernization of Ukraine’s gas transit system, implementation of which may lead to the fact that “Gazprom” will have to sell gas on the border with Ukraine.

The adopted document introduces the new rules of the game at the European gas market. Each of the EU countries is offered one of three schemes for choice. The first variant assumes the compulsory property division of vertically integrated holdings: energy companies must sell their

transport networks to independent operator and will not be able to have the controlling interest in it. The second variant allows the extracting companies to remain the owner of transport networks. However, in this case the network management should be fulfilled by the specially made “independent system operator”. The third variant also assumes the preservation of vertically integrated corporations, but their activities will be controlled by the special “supervisory body”. The European countries are given 3,5 years for implementation of these rules.

It is mentioned in the document that these rules should be used not only in relation to European companies but also in relation to the firms from the third countries working in the EU. It is mentioned in the “Third package” that the governments of every European country may deny the company the right to access to its internal market in two cases: if the company does not correspond to the requirements on division of extraction and transport, or if its appearance at the market may pose a threat for the EU Member States’ energy security.

Russian “Gazprom” always described the planned liberalization in the EU almost as a catastrophe. Deputy Chairman of the company’s Management Committee Oleksandr Medvedev said more than once that it would destroy the existing scheme of supplies<sup>13</sup>. But it is most likely that such EU step will deprive Russia of its intentions to use the gas factor as a strategic weapon in the struggle for geopolitical dominance over Ukraine and Europe. As soon as they give up these geopolitical ambitions concerning Ukraine and Europe, Russia will not need to have a monopoly on the sources of extraction of resources, on transport routes and on the market. Then it will play as an economic player. And all these conflicts will be simply forgotten. And the issues of establishing control over the pipe and gas infrastructure will be not vital for Russia itself because it will use any routes. Only the issues of price and money will be discussed. Although today the Russian Federation pursues geopolitical interests in the European direction, it will be short of resources for implementing these interests in the long-term prospect. And no matter how Putin is bluffing today that Russia may give up gas supplies to Europe, Russia will come to terms objectively.

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How will Ukraine use these opportunities? Time will show.

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<sup>13</sup> Media: European Parliament will leave “Gazprom” at Ukraine’s border. April 23, 2009 | 08:35. / <http://podrobnosti.ua/economy/2009/04/23/597953.html>

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## **CHALLENGES AND THREATS FOR ENERGY SECURITY OF UKRAINE AND THE EU RESULTING FROM THE GAS CONFLICT WITH RUSSIA**

When spring came and volumes of gas consumption in Europe reduced appropriately the discussions concerning the future of the Ukrainian gas pipeline system became more calm and pragmatic in nature. The National Joint Stock Company Naftogaz of Ukraine under the wardship of the Cabinet of Ministers of Ukraine and the Secretariat of the President of Ukraine pays off for consumed gas in time. European officials assure their colleagues from Russia quite actively and convincingly that nothing that could offend them took place in Brussels on the 23<sup>rd</sup> of March. The Declaration signed in Brussels defines the necessity of reforms in Ukraine’s gas sector directed to increase of transparency of its activity and liberalization of gas market. The EU and its financial institutions will encourage ensuring of funding of modernization of the Ukrainian gas pipeline system.

Financial and economic crises made the Europeans look for the most optimal solutions in the sphere of gas supplies, making maximal use of the existing gas transmission infrastructure at least for the time of crisis.

It should be recognized that the Ukrainians’ behavior was wise at this time. Kyiv has not instructed its neighbors which route they should use for gas transportation, but instead of this it has expressed its readiness for improvement of “Naftogaz of Ukraine”, liberalization of its own gas market and wide modernization, and if necessary further development of the gas pipeline system. Ambassador of Germany to Ukraine Mr. Hans-Jurgen Heimsoeth has declared this week that in his opinion, Russia’s claims to the Memorandum signed at the International Investment Conference on modernization of Ukraine's gas transit system are not quite reasonable. “Russia was not excluded from this process; on the contrary, it played a key role at the round table (i.e. during the preparation of the document – *author’s note*)”, – the diplomat mentioned. Considering that historical background changed to some extent, the Ambassador also emphasized, the trilateral document (between Ukraine,

Russia and Germany – *author's note*) on creation of a gas transportation consortium signed a few years ago began to lose its topicality.

In response to numerous provocative warnings that the EU just like Russia aspires to take control of Ukraine's gas transit system, including with desire to become its owner or, at least, co-owner, the Ambassador emphasized: "The main thing for us is how to reach more transparency in gas supplies to the EU countries and strengthen the energy security. All that does not concern the issue who is the owner of gas pipe lines – this is not discussed". He also emphasized that first of all, the issue was discussed at the conference under what conditions it was possible to engage Western financial institutions into modernization of Ukraine's gas transit system. "Ukraine is a sovereign country. Just like Russia it has a right to control its gas transmission networks", – Director General of European Commission Directorate General for External Relations Eneko Landaburu stated at the end of the first April week.

After turning its attention to own internal and external problems related to the crisis Russia's position is becoming more and more weighted and calm. And this strengthens the basis of the platform of further negotiations among all participants of the gas market in Europe, and what is important – Ukrainian – Russian relations. The first features of improvement of relations between Kyiv and Moscow are becoming quite notable. After the telephone conversation with the Prime Minister V. Putin on the 10<sup>th</sup> of April the Prime Minister of Ukraine Y. Tymoshenko declared (concerning the controversies that emerged after the Summit in Brussels on modernization of Ukraine's gas transit system – *author's note*): "We found out that we are the partners in modernization of the gas transit system. We consider that the issue has been taken off and we can continue our work". Although a great number of politicians and experts are still wondering which secret agreements were touched on by Ukraine in Brussels that caused Russia's unreasonable offence and rage. But, most probably, this information will be made public in the future, considering the fact that there will be presidential elections in Ukraine soon. And if some agreements unpleasant for Ukrainians were reached, they may become the "time-delay bomb" which will be used by Russia at the most inappropriate moment for Ukrainian participants.

Probably, the most difficult issues for Ukrainian authorities will be not so much as the issue of sources of getting the long-expected finances, but the deficit of the Ukrainian team's skills and the proper level of political will necessary for implementation of so long-expected in Ukraine and neighboring countries reforms which will open and improve the work of "Naftogaz" and Ukraine's gas market. Too many interests of oligarchic groups, political forces, creditors are concerned here, and each of them will be afraid to lose his own in this process. That is why the strategy and tactics in solving, first of all, the Ukrainian problems should be very well thought-out as the price of the failure

in realization of the Brussels Declaration may become too high for Ukraine and the future of its gas transport system.

### *Threats for energy security of European countries*

Analyzing the “gas wars” the experts mention that the term “energy security” in Europe began to be perceived as the strengthening of suppliers’ influence and weakening of importers that in its turn means the drastic reduction of competition and increase of political vulnerability in the new millennium. The Kremlin and Gazprom’s strategy in the “gas war” includes at least three main tactics:

- cooptation – cultivation of partnership relations with some countries, political leaders and corporations for protection of own interests;
- prevention – use of Russian diplomacy for influence both on the supplier and on the conditions in distribution network and preservation of assets;
- disaggregation – disunion of the EU through bilateral agreements.

*Cooptation* of Europe by “Gazprom” is reached mainly with the help of Germany where partnership relations with energy companies and banks helped to gain the authorities’ support. Strong lobbying both directly and through the intermediaries is carried out now in order to convince the European regulatory bodies to allow concluding the long-term contracts on gas supplies to the EU, despite their negative influence upon the competition.

*Prevention* is realized by “Gazprom” through a great number of purchases, and what is more terrible – through a series of gas and oil cuts-off or proposals concerning preferential access to the market for agreeable partners.

*Disaggregation.* The pipeline project “Northern Stream” which is supported by Germany but strongly opposed by Poland and the Baltic states is the best example in this context. Today the European Union imports 50% of energy it consumes. Even considering the large-scale crisis, in 2030 this share may reach 70%. This index is usually called the “dependency ratio”. The so-called “energy independence” is not possible for the most of developed countries. Even under the ideal conditions of free access to energy resources, everybody knows that it is not likely that the world production, f. e. of oil, will exceed 100 million barrels per day (in comparison with 85-90 million barrels produced today), but the demand will reach 120 million barrels already in 2015-2020.

Security of gas supplies in the long-term prospect has no more guarantees than the oil. The main distinction of gas from oil is that it can be substituted by other sources of energy almost in all spheres of use. Although for environmental reasons the natural gas will remain a priority energy resource. Natural gas supplies from Russia to the EU countries account for about 42% of volume of imports. And 80% of gas export from Russia is transported through the territory of Ukraine, due to its

geographic location and high infrastructure potential. There is no more economically profitable alternative for the EU countries.

The main threats for energy security of European countries may be considered the following ones:

- threats of political character:
  - lack of a unified position of the EU Member States concerning Europe's energy strategy, solidarity and coordination of actions;
  - lack of the EU jointly defined effective internal and external energy policy;
  - lack of a unified position concerning the priority ranking of alternative transport corridors.
- threats of technical character:
  - weak integration of the EU internal gas pipeline system and inconsiderable volume of underground gas storages;
- foreign policy and economic character:
  - Russia's aspiration to take control of the gas pipeline systems of other countries.

For the purpose of prevention or neutralization of the above mentioned threats the specialists recommend making the following steps:

- to extend and to activate an open discussion and consultations between suppliers, consumers and transmitters of energy products for the purpose of promoting the mutual understanding and the possibility of coordination of actions;
- to create the effective mechanisms of joint actions which would inspire confidence in the European Union countries and its nearest neighbors;
- to launch the implementation of political, technical-and-economical and legal efforts concerning creation of the Trans-European energy networks, with reservation of their capacities and maintenance of reliable redundant operating modes;
- to establish conditions for public discussion and analysis of important energy projects, with defining their role and place in the Common European energy security system;
- to consider modernization and development of the existing energy system in the light of the new realities on the geopolitical map of the world;



- to strengthen the role of liquefied natural gas (LNG) in the gas supply system of European gas market;
- to establish conditions allowing sufficient freedom of movement in relation to supplies from Russia, extending the use of energy sources substituting the gas and putting a priority on nuclear power for a transition period.

A positive result of the gas conflict between Ukraine and Russia for the EU countries is an attempt of coordination of actions and development of the mechanism of solidarity in making the decisions. The recent events confirmed the necessity for diversification of energy supply sources once again, particularly in relation to the new suppliers and an opportunity of use of the liquefied natural gas infrastructure as an alternative source.

Security in Europe will also depend on the level of integration of the internal energy and gas pipeline system and quick reacting for the Member States' needs. As a number of European experts mention in their reports, the EU works upon the implementation of the idea of pan-European energy community. Its main provisions are the extension of legal regulations concerning free trade in energy and gas, the joint demand management according to the principles on energy efficiency and environmental protection.

As experience shows, realization of the strategic plan «20+20+20 and 10» did not lose its topicality – it is becoming one of the most important priorities. Diversification of the EU energy balance with emphasizing on renewable energy sources will make up an important part of Europe's additional energy potential.

Strengthening the energy security of Europe is possible only due to the enhancement of energy efficiency. As the EU experts mentioned, the energy efficiency potential of the EU countries twice exceeds the gas export from Russia. The energy-saving and energy-efficient projects form the basis not only for the EU energy secure future, but also for development of joint actions in global cooperation in energy, political, economic spheres using the scientific potential of the whole world.

### ***Recommendations concerning the policy***

The tendency for drastic increase of gas consumption causes a discussion on “gas supply shortage” to the EU which is expected in 2020. In 2008 E.ON estimated the supply shortage at the level of 21% in 2020, while other EU/Commission sources stipulate the supply shortage only at the level of 5%. It is interesting that according to the mentioned assessments Russia's share should reduce by insensible degrees, but permanently till 2020. After the events in January 2009 there are more arguments in favor of these estimations.

On the other hand, we stipulate the first features of change of the type of dominating energy generation. According to the expectations, the third change of generation may lead to the transition from hydrocarbonic energetics to mainly nuclear and hydrogen power. The problems emerge not because of the need in change of the type of generation – by reason of depletion of oil and gas – but because of the rhythm of change and side effects. In this aspect the increase in investments, cooperation and scientific research in the sphere of alternative energy sources including the technology transfer may become a priority. However, the economy based upon hydrocarbons will remain a principal form of development for the next decades.

In the context of unstable dynamics or advance in prices for hydrocarbons, it is necessary to create the international regime which would make impossible the price escalation by suppliers – monopolists and would minimize temptations for use of the price dictate mechanisms. The regime should include the supplier's ability guarantees, transit security from the transitters and the consumers' willingness to realize the projects both on development of natural gas production and creation of additional infrastructure, and modernization of operating capacities. The parties' joint efforts on monitoring of threats for security of gas supplies are necessary. Greater transparency of gas sector along the whole length of the gas chain is also necessary: from gas production to gas consumption. Gas crisis in January 2009 indicates once again a need to take such measures by the international community.

Oil price is a very sensitive issue dependent on the conflict zones, terrorist attacks and natural disasters. As it was proved, the competition instruments are the most effective ones. In this aspect all interested countries – consumers should avoid a monopoly on any kinds of energy. This also concerns the creation of the cartel of producers. Transit countries should join the EU energy market. The necessary condition is introduction of competition and division of productive, transport and distributive assets. This is the most effective way of maintenance of realistic market prices acceptable for all consumers. The rules cover the EU Member States and the countries involved into the European Neighborhood Policy, both the private and public owners of the companies registered in the EU and beyond its borders.

### ***Recommendations received by the EU countries***

“Energy and Climate” sphere is one of the most important spheres for the EU. The EU Programme on Energy and Climate approved in January 2007 contains very severe requirements. On the basis of these requirements the EU countries should reconsider and improve the Action Plan adopted in spring 2007. This includes:

- Common Energy Security Policy and Foreign Policy;

- examination of the internal gas market and energy market (compromise stricken during the Slovenian Presidency);
- achievement of the EU's strict, realistic and consistent joint position concerning the Package of Documents on Climate which should be represented in international negotiations in Copenhagen in December 2009.

Energy security should be based upon the key principles of the European Union's activity. They are as follows:

- *solidarity* which is declared in Article 5 of the EU countries' joint declaration, according to which "any invasion of the energy supplies in relation to any EU Member State will be considered as invasion of the energy supplies of the whole EU";
- *unity*: "speaking one language" about the energy issues that means the internal solidarity – European transport network and European storages; and external solidarity – joint understanding of sources and ways of energy supplies which prevails over the national principle of conclusion of independent agreements on energy supplies;
- *introduction of security of supplies* in the attributes of internal market regulators.

Urgency of the above mentioned positions grew suddenly against the background of Russia's energy aggression against Ukraine and the EU in January 2009.

Concerning the Package of Documents on Climate, the EU countries are planning to reduce carbon emissions for 20% till 2020, and even to reach 30% level if an international agreement is concluded. The system of exchange of quotas for emissions allows each country to achieve a purpose established by its own policy. In the sphere of alternative resources the EU is planning to reach production of 20% of energy from clear sources – wind, sun, water, and 10% from biofuel. It is also planned to enhance the effectiveness of use of energy for 20% till 2020 according to the special national programme.

### *Issues related to security*

The January 2009 events are comparable by their scale and meaning to the October 1973 events – the Arab oil embargo. In order to avoid the recurrences of energy aggression in the future, the system of confidence building measures on the Eurasian scale should be initiated – from production to consumption. It could be called as an Energy Transparency Initiative (ETI). Consumers no matter in which country they are – in Russia, Ukraine or the EU – have a right to know the parameters of energy products traffic, as all that is paid in the end at their expense. What energy resources are produced, how much is directed into the pipeline, which are the available capacities for transportation, how much of free capacities are in the pipe, which are the expenses for transportation, how much of the energy

product is directed into the transiter's pipelines and how much of it is obtained by the consumer, which are the consumer's needs, etc. – here is the main list of information that should be available, but not be concealed by monopolists as carrying a privacy mark. When all participants of the chain “production – transportation – consumption” will be open before each other, this will create the system of confidence. The European continent is in need of the original procedure of making the energy sector more transparent, especially it concerns the gas segment, as mainly monopolistic structures work here. Every consumer has a right to know whether he pays the economical price, where and how the state monopolists' incomes are directed and distributed, which role the intermediaries play and how much the consumer pays for this. Such transparency system is not just an academic fancy; this is a peculiar system of diagnostics and early warning of possible problems.

Security of the alternative way from the Eastern Caspian/Central Asia to Europe depends on the corridor Azerbaijan - Georgia - Black Sea. That is why the Black Sea region should be a safe place for transit. The latest Russian aggression in the Southern Caucasus showed that there is a high risk of blocking this corridor, or discontinuing the transportation through the existing pipelines in this region.

This threat leads the European community to the definition of several tasks of primary importance:

- ensuring the security of the Black Sea region;
- associating the security of the EU and NATO European members with security of the above mentioned corridor and the Black Sea region;
- associating the security of Azerbaijan, Georgia and Ukraine with the NATO countries security;
- strengthening the strategic relations between the EU and Turkey and Ukraine;
- implementation of provisions of the Declaration of the NATO Bucharest Summit in the context of ensuring the energy security and safety of pipelines;
- ensuring the security of supplies through the protection of vulnerable points of the pipeline networks and through the guaranteeing the availability of capacities for rapid reconstruction of the pipeline after the attack;
- creating the alternative formulas of relations between the EU countries and transit countries and preparing the alternative routes of supplies for transit countries, ranging from the open sea ports with the “reverse traffic” for the prevention of possible blockade of supplies through the usual Eastern-Western direction.

Projects «Nabucco», «White Stream» and Odesa-Brody-Gdansk concern both of the issues – security of the Black Sea region and the new guarantees for the countries involved. Implementation of the Southern Gas Corridor projects will be an indicator of the EU ability / inability to realize a common energy policy.

The EU should offer a comprehensive package of documents for the transit countries, in particular: Azerbaijan, Georgia, Ukraine and the Republic of Moldova, which should include the introduction of visa free regime, free trade area with the EU and involvement into the Energy market.

In addition the European Union should conclude a strategic agreement with Azerbaijan on energy, transportation, economic and social development, and adopt a package of documents on ensuring the security for Azerbaijan through the agreements with NATO and the EU.

### ***Recommendations concerning relations with Russia***

There are still very different views on relations with Russia in the EU. In general, they come down to two fundamentally different positions. The “West-European point of view” is based on the idea that there should be a single energy market from the Atlantic to Vladivostok. The “East-European point of view” reflects the understanding of the fact that the “new Cold War” is breaking out through the gas sphere with using the energy resources as an energy weapon.

Relations with Russia are becoming more and more problematic. The January 2006 and 2009 events in Russian-Ukrainian gas relations, the Russian-Belarusian disputes in 2004 and 2007 in gas and oil sectors point to Russia’s system actions on use of the energy resources as an instrument of political pressure. “Gazprom” extended 80% of the long-term contracts with the EU till 2025-2035, but the issue of ability of fulfillment of these commitments is still open. Therefore, a number of requirements to Russia are quite logical in these circumstances:

- ratifying the European Energy Charter (and only after this negotiations on its modernization);
- demonopolizing Russia’s gas sector and creating a competitive market;
- access of independent gas producers to the export pipelines and their access to foreign markets;
- foreign companies’ access to Russia’s extractive industries, abolition of provisions of the legislative acts that discriminate the foreign companies’ participation in hydrocarbon production.

It is necessary to mention the first victories of the German company RWE in the sphere of demonopolization of gas sector which signed a preliminary agreement with Turkmenistan on gas supplies through the project gas pipeline «Nabucco». This event may become a determining one in the policy of diversification of sources and routes of gas supplies in Europe.

### ***Recommendations for Ukraine***

“The EU and Ukraine have common interests in the energy sector. Both the EU and Ukraine may benefit from the integration of their energy markets, thereby increasing the level of energy security of the European continent”, - this is mentioned in the Memorandum Ukraine - EU on mutual understanding in cooperation in the energy sphere from the 1<sup>st</sup> of December 2005.

Ukraine’s energy sector needs deep reforming and implementation of the package of unpopular measures that were postponed constantly under the influence of political factors (elections) and social populism. An absolute positive consequence of the gas crisis in 2009 is the elimination of non-transparent intermediary structure “RosUkrEnerg” from the gas trading system. This is a necessary but insufficient step for ensuring the transparency of the gas sector.

Energy tariffs in the industrial and consumer sectors should reflect the real cost of imported or domestic energy resources. The government should determine the utility tariff raising schedule, and introduce the measures which will reduce the impact on the poorest ones in consequence of tariff raising. Local producers of raw hydrocarbons should sell it at the same prices as the foreign suppliers do.

For the purpose of gaining access to the open energy market Ukraine should make efforts. It should join the Treaty on Energy Community as a full member. Ukraine has to harmonize its current legislation, keeping to the schedule outlined in the annexes to the Treaty. In addition, it should restructure the National Joint Stock Company “Naftogaz of Ukraine” in order to complete the division of production, transportation and distribution between the independent enterprises. The company “Ukrtransgaz” must gain financial independence again. Tariffs for gas transit and gas storing in underground gas storages should cover the costs for modernization and reconstruction of the existing pipeline system.

Step-by-step implementation of the projects stipulated in the Brussels Declaration of the 23<sup>rd</sup> of March 2009. In particular, the following steps should be taken: modernization of the Ukrainian gas pipeline system through the fund planned by the European Commission; equipment of the main pipelines with modern gas-measuring stations and metering stations; adverse use of the Odesa-Brody pipeline in connection with construction of the Baltic Pipeline System – II planned by Russia.

Ukraine should try to reestablish direct relations with Turkmenistan and Central Asian suppliers with the assistance of the European Commission. It should offer the national gas companies of the Central Asian countries an access to the Ukrainian gas market through the appropriate joint enterprises. It ought to restart the process of creating the Strategic Oil Reserve (SOR) and the State Agency on SOR Management in accordance with the European practice and best practices recommended by experts of the European Commission in 2005.

Ukraine should reduce taxes on perspective projects related to research and development of mines to the level which meets the European standards. It ought to facilitate the procedure of obtaining

licenses for production for the license holders for research that will encourage the additional foreign direct investment in the hydrocarbon production sector, both on the sea and on land. Ukraine has to use transparent competitive procedures for issuance of licenses for geological exploration and production, to make the conditions of termination of licenses and permissions more understandable and transparent that stipulates the reforms in legislative and judicial systems.

It is also necessary: to create a mechanism through which the companies that discovered the deposit would have a right to obtain licenses for production without a new tender procedure; to improve the taxation and other conditions of the income distribution; to elaborate the program of development of hydrocarbon resources of the Black Sea shelf in collaboration with the European Commission.

Transparency will be crucial for preservation by Ukraine of its energy transit potential on the East – West line which turned out to be under the threat caused by – not least of all – non-transparency of functioning of Ukraine’s oil and gas sector. In this context completion of the projects on creation of the Metrological Center in Boyarka and equipment of the Eastern and Northern areas of the state border with gas-measuring stations and metering stations will have an indicative meaning for the EU.

It is reasonable to create the nation-wide online resource with a complete register of operators and their owners in the sectors of energy industry. Perhaps, it would be reasonable to make the economic agents more transparent (some lustration), especially those ones related to the non-transparency of functioning of oil and gas sector, or their legal successors. If it is found out in consequence of such lustration that a share of market operators’ incomes was generated at the expense of inadequate rates of tariffs and prices, this would give occasion to conduct special investigations with appropriate financial or property sanctions in case of confirmation of abusive practices.

Transparency of contracts, tariffs and prices is of great importance. In this context the Energy Charter Secretariat recommends the Estonian experience where the Consumer Protection Council was established which functions as a public supervisory body that protects consumers at a low level.

The Verkhovna Rada of Ukraine jointly with the Government should take the lead of publishing the real volumes of earned incomes, expenses, tax payments to the budget, indirect taxes, payments to the non-budgetary funds, sponsor support, received credits, debts of “Naftogaz of Ukraine”, long-term contracts for the whole 10-year period of existence of this monopolistic structure.

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The January 2009 events turned out to be a "third bell". The first one rang in 2004 during the Russian-Belarusian gas dispute – it was almost ignored, the second one – in January 2006 – led to the elaboration of a common European energy policy which was just on paper. In these cases Brussels repeated a stereotyped assessment imposed by the monopolist – “everything that happens is just a

commercial dispute”. It is clear that Ukraine looked quite poorly in the eyes of the EU during the gas crisis. Its image was misrepresented through the previously prepared propaganda organized by “Gazprom” and the Kremlin. But Europe also looked in the eyes of Ukrainians as such which did not learn to speak in unison, even in emergencies.

Considering that Ukraine has already received common borders with the EU, and the joint energy projects have become an important component of European energy security, our country should be integrated more systematically into the European energy sector with the adoption of uniform norms, standards, with incorporation of energy systems, transport infrastructure, joint creation and use of strategic storages of hydrocarbons.



## **ENERGY AND FOREIGN POLICY AFTER THE GAS CRISIS: according to the materials of Berlin discussion of Ukrainian and German experts.**

A number of discussion meetings of the leading Ukrainian experts in the field of energy security and foreign policy with the Bundestag members, officers of the Ministry of Foreign Affairs of Germany and members of the leading scientific and analytical German centers took place on the 2<sup>nd</sup>-5<sup>th</sup> of March 2009 in Berlin. These meetings were initiated by the Regional Office of the Friedrich Ebert Foundation in Ukraine and Belarus.

The Ukrainian delegation was represented by Ambassador Extraordinary and Plenipotentiary of Ukraine, director of the Institute for Sustainable Development Shcherbak Yuriy Mykolayovych; editor of Economic Department of the newspaper “Dzerkalo tyzhnya” Yeryomenko Alla Ivanivna; director of the Foreign Policy Research Institute of the Diplomatic Academy of Ukraine under the Ministry of Foreign Affairs of Ukraine, professor of the Kyiv Taras Shevchenko National University Perepelytsya Grygoriy Mykolayovych; energy expert of the Center “NOMOS” Gonchar Mykhaylo Mykhaylovych; representative of the Regional Office of the Friedrich Ebert Foundation Mykhalnyuk Taras.

Discussion with German scientists at the Science and Policy Foundation was the first one and the most detailed one. The main topic of this discussion was the gas conflict between Russia and Ukraine, as well as its impact on the Ukrainian – German relations and the process of Ukraine’s integration into Europe. German experts noted that there was no clear view of Ukraine’s place in Europe and consequently in the system of Germany’s foreign policy interests among German politicians.

In general, formation of political idea in Germany concerning the identification of Ukraine’s place in the system of international relations changed to some extent. It may be divided into two stages. At the first stage Ukraine was perceived as a part of Russia. In the future, the post-Soviet space was perceived not only as Russia, but also as some other countries. Considerable changes in views on Ukraine’s place in the world in the German political idea took place after the Orange Revolution. Then Ukraine was perceived by Germans as a perspective European project. However, this huge international resource was not realized by Ukraine. Now Ukraine is perceived in Germany as a problem country. According to German scientists, Ukraine’s integration into the European Economic Space was a prospective line of Ukraine’s development.

Discussion in the German Society for East European Studies was also quite fruitful. The topic of the discussion was “Lessons of the gas conflict for stability and security in Europe”. The experts mentioned that the gas conflict was a significant challenge for security both of Ukraine and Germany. During the gas conflict public opinion in Germany was being changed constantly, however, rather large scepticism is still observed in relation to Ukraine. Influential forces in Germany have significant economic interests in Russia. But in consequence of the gas war they failed. Russia showed to the

German society that it could not be a reliable partner. Although it was prepared for the information campaign very well which was launched before the gas conflict?

After the gas conflict the skepticism is observed in relation to both Russia and Ukraine in Germany's public opinion. The reasons for this skepticism lie in the non-transparency of relations between Ukraine and Russia in the gas sector. Now the main idea is that the European Union should work both with Russia and with Ukraine. The EU did not want to get involved into this gas conflict and it does not want Ukraine and Russia to blackmail it. Ukraine should conduct the offensive policy in international information space and explain its position.

Regarding cooperation between Ukraine and Germany in the gas sphere, the experts came to the following conclusion: in order to provide stable supplies of energy resources to Europe the Ukrainian gas pipeline system should be modernized and Ukraine should become free from its energy dependence on Russia.

Meeting with the leading German experts in the headquarters of the Friedrich Ebert Foundation was also very interesting. During the discussion it was mentioned that the gas conflict reflected the global changes in using the energy resources. Advance in price for energy resources makes everybody dependent on oil and gas. Especially it concerns Germany as in due time the government refused to use nuclear energy and reoriented itself for the large volumes of gas consumption. Orientation for gas as for the main energy resource made Germany asymmetrically dependent on foreign suppliers.

What are the ways of getting rid of this dependence? Unfortunately, in the short-term prospect, Germany will not be able to invest a large sum of money in alternative energy resources. At this stage the main thing is to provide independence and reliability of supplies of energy resources. Reduction of gas consumption also seems to be quite effective. Although it is known that gas is an important raw material for chemical industry. It is necessary to substitute gas by consumption of coal and other kinds of energy resources in energy industry. It is also necessary to enhance the transparency of gas market.

Diversification of sources of energy raw materials and routes of their transportation seems to be quite perspective. However, the long-term prospect is in the strategy of renewable resources. This direction of energy policy requires cooperation in the field of development of new technologies. It is necessary to restructure the capital flows in the world and to direct them to investment in new technologies.

Discussion of Ukrainian experts with the Bundestag members turned out to be very fruitful. According to the results of this discussion its participants came to the conclusion that Germany consumed and produced the energy resources most of all. Industry consumes most of the gas. Private sector also consumes the large gas volumes.

In the 50's Germany ensured its energy security using coal. In the 70's it began to import more and more gas not only for the power production, but also for the private sector. In 2018 Germany

should stop the coal mining. It almost has no own gas deposits. Germany imports more than 80% of gas. Among the largest gas exporters for Germany is Russia (1<sup>st</sup> place) and Norway (2<sup>nd</sup> place).

The EU and Germany's energy concept is directed to meeting three goals:

- energy security;
- ecology;
- cheapening of energy resources.

Energy efficiency is in the first place. The main energy efficiency measures should be focused on transport, heating the buildings and modernization of power stations. It is necessary to combine all measures in order to increase the energy efficiency two times till 2020. The German Energy Agency is to achieve these objectives in Germany.

The second part of the energy strategy is directed to renewable energy resources, particularly, use of biogas along with the natural gas. Germany increased the share of renewable energy from 3 to 5%. Priority is given to wind energy the share of which is to be increased in Germany's energy balance by 30%. Biomass also has an increasing meaning. The third part of the strategy is in ensuring the availability of energy for consumers.

History of Germany shows that increase in production, increase in energy consumption and energy dependence brought together Germany and the USSR and led to the Second World War. The price for coal has been increasing lately. Situation with oil is more difficult. Most of oil is in politically unstable countries. Difficulty in providing with gas is in the fact that gas supplies are made through the pipelines. The gas countries alternatives to Russia are also quite difficult in political aspect. Liquefied gas will play an additional role for Germany in the future.

There is no consolidated position on the country's future energy strategy among the political parties of Germany. Thus, the Christian Democratic Union and the Liberal Party oppose the refusal from nuclear energy. The Green Party is against the use of nuclear energy. They hope for renewable resources. Today the Social Democratic Party has no permanent and clear position on the future of energy security.

Today Germany introduces the combined methods of energy production and develops the new technologies that exclude the carbon emissions at the coal-fired stations. In its foreign policy Germany tries to maintain a balance between the EU and Russia. As some German parliamentarians mention, the guarantee of this is a 30-year experience of reliable gas supplies from Russia, considering the fact that Russia is interested in investments and technologies in German – Russian relations, except for the geopolitical aspects.

Meeting with the experts of the German Council on Foreign Relations was quite productive and quite debatable one. Expressing their views on the future of European security, the experts of this analytical institution mentioned that Germany identified itself as a country which was incorporated in

the context of European geopolitics. Germany does not imagine the European security without Russia. Such position was formed in the 90's. It is necessary to understand that Russia will not be a democratic country. However, according to German experts, Ukraine cannot solve its security problems using the West. Russia may not join NATO and the EU but it wants to join the European security system.

Some time ago Germany was also against the Baltic States' accession to NATO. With the third NATO enlargement the economic interests related to Russia were clearly defined in Germany – they go along with its political interests. Moreover, the Western elite thinks about the post-Soviet space through Moscow. We have just begun to understand this. German experts consider that NATO has become a larger organization today than it may be. The NATO Members have different points of view on the Alliance's role.

For Germany participation in the NATO mission in Afghanistan was a compensation for its non-participation in Iraq. Policy of the USA will not change particularly in relation to Europe. German elite thinks little about Ukraine. It thinks about Ukraine only through Moscow. Certainly, Ukraine is very important in the context of energy. But it is unclear for the German elite what happens in Ukraine. First of all, it is disturbed by the gas crisis and unstable political situation in Ukraine which may cause the bankruptcy of the whole state and the complete collapse of financial system. The same situation is also observed in other countries. But what is dangerous in Ukraine is that the government structures dysfunction. In order to cope with the financial crisis there is a number of international instruments such as the IMF. However, it is quite difficult to imagine that Ukraine may adhere to conditions of the International Monetary Fund. That politician who will follow the IMF requirements will be unpopular in Ukraine.

With regard to Ukraine Germany speaks about the unpleasant news. There are some NATO Members that agree with Ukraine's wishes. However, there will be no such pressure which was put by the USA upon NATO Members concerning support of Ukraine as the NATO Membership Action Plan is only for the applicants. Germany mentioned at the Bucharest NATO summit that there were a number of internal problems in Ukraine. The issue on NATO membership is a controversial issue in Ukraine itself.

Russian vector plays a very important role that should be taken into account in Germany's foreign policy. According to German experts, politicians and diplomats, NATO policy on its enlargement should consider 2 key factors:

- the country's concentrated desire to become a NATO member;
- accession to NATO should promote strengthening the European security.

On the basis of these two factors Germany cannot make a rash decision. It is necessary to balance these opposite factors. And that is why Ukraine and Georgia's NATO membership is not on

the agenda of the German foreign policy. For Germany Ukraine would remain an important country if there were no unstable internal situation in the country.

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It is obvious that the experience in ensuring the energy security of Germany may be useful for Ukraine. In general, holding of such Ukrainian – German discussions promotes clarifying the positions of Ukraine and Germany, realizing the mutual problems and finding the optimal ways for their solution.