

Ukraine & Moldova and the Energy Community

Wojciech Konończuk, Sławomir Matuszak

When Moldova and Ukraine joined the Energy Community in May 2010 and February 2011 respectively, they committed themselves to adopting and implementing a series of European Union directives relating to gas, electricity, renewable energy and environmental protection. Although the deadline for implementing most of these measures has passed (at the end of 2010 in the case of Moldova, and this January for Ukraine), it is Chisinau which has made some progress, mainly in the electricity sector, whereas Kyiv has failed to meet fully a single one of its obligations. In Ukraine, these delays are being caused by internal factors resulting from a lack of political will for reform, as this would strike at powerful business interests. Meanwhile in Moldova, the relevant reforms were prevented by a prolonged political crisis. An essential factor in both countries has been pressure from Russia, which is trying to block their integration with the EU in the energy sector. It seems that Kyiv will not really resist giving up membership in the Community in return for a reduction in the price of Russian gas. On the other hand, if Moldova met all its commitments, this would expose it to a serious dispute with Moscow because of Gazprom's dominant position in the country's gas sector. This would mean the failure of the EU's energy policy for these countries in its eastern neighbourhood, which was aimed at introducing an EU model of organisation to the energy market.

The parties' obligations

The objective of the Energy Community (EC), which was established in 2005, is the creation of a common energy market through the implementation in several stages of the relevant EU regulations by its members (the EU, seven Balkan countries, Ukraine and Moldova). In addition, in October 2011, all the members of the EC agreed to adopt the third energy package by January 2015.

Kyiv and Chisinau's main obligations were to reform the gas sectors in their countries; this involves the separation of the entities involved in the extraction, transport and sale of gas. Similar rules are to be introduced in the electricity market. Moreover, Ukraine and Moldova are committed to limiting the emissions of certain greenhouse gases and promoting the development of renewable energy production. The deadline for implementing most of these directives passed on 31 December 2010 in the case of Moldova, and 1 January 2012 for Ukraine (see Appendix). From the information available, it appears that in accordance with

its obligations under the EC Directive, Moldova has so far adopted measures leading to the partial regulation of the electricity and gas markets, as well as others concerning energy efficiency. Despite the adoption of these commitments, however, there are still problems with implementing them. Ukraine, on the other hand, has not met any of its obligations completely, and in most cases the work is at a very early stage of preparation. Although reforms have begun in the gas sector (a law on the gas market was passed in 2010, separating the functions of the companies operating on the market), no further practical action on restructuring the state-owned Naftogaz company has been taken.

Internal reasons for the delays

In Moldova, the main cause for the delays in implementing the EU's directives was the protracted political crisis associated with the parliament's inability to elect a president, together with the ineffectiveness of the Moldovan government. Despite these obstacles, Moldova has made some progress in implementing the new energy law; this was also possible due to the lack of a national lobby to block the reforms, which is part of the problem in Ukraine.

Statements by Ukrainian government representatives show that Ukraine has had inflated expectations associated with its membership in the Community. The top priorities for Kyiv were blocking the construction of the South Stream gas pipeline (which will bypass Ukraine), and the rapid acquisition of funds to modernise Ukrainian gas transit pipelines. When it became clear that those hopes were misguided, the Ukrainian government's reformist zeal weakened, and Kyiv began to question the wisdom of its membership of the EC. Large parts of big business, as well as the political elite (which draws an informal income from the gas market), have no interest in introducing transparent operating principles. The slowness of reform is also partly due to the inefficiency of the Ukrainian government, as well as the complexity of the changes needed, which will require the adoption of a complex series of legal acts and will incur high costs (especially the regulations on environmental protection).

However, the Ukrainian government has in some cases taken advantage of its commitments to the EC as an excuse to change the law in favour of the oligarchic groups. One example of this is the government's decision in April 2011 to abolish Naftogaz's monopoly on gas imports; this worked in the interest of the businessman Dmytro Firtash, because it allowed him to make direct purchases of raw material from Gazprom. Also, the plan for integration with the EU electricity network, which would enable increased electricity exports to EU countries, is of interest to the richest Ukrainian businessman Rinat Akhmetov. We may thus expect that despite the delays, work on integrating the Ukrainian and EU energy networks will continue.

The Russian factor

In both countries, one of the main reasons why it is taking so long to implement the Energy Community's commitments is the position adopted by Moscow. Ukraine and Moldova have been negotiating with Russia about gas for several months now. Kyiv wants to change the agreement it concluded in 2009 (to reduce gas prices), and Chisinau is negotiating a new agreement on gas deliveries (the previous one expired at the end of 2011, but has been temporarily extended until the end of this June). Ukraine's implementation of the EU's energy regulation model, including in particular the third package, would significantly impede Russia's main objective of taking over Ukraine's gas sector. The importance that Moscow attaches to undermining this agreement is demonstrated by the draft of Ukrainian-Russian gas agreements which leaked to media in December last year. These show that a joint venture between Gazprom and Ukraine's Naftogaz to manage Ukraine's gas pipelines would not be covered by any changes to Ukrainian energy legislation, and in the event of any conflict with Ukraine's previous commitments, priority would be given to the Ukrainian-Russian agreements.

In Moldova, Gazprom, which controls the country's gas monopolist Moldovagaz (with 50% of the shares), including the distribution network, is interested in maintaining the *status quo*. The Russian company has linked the extension of its contract to Chisinau giving up its gas sector obligations arising from membership in the Energy Community, as implementing them would mean a significant weakening of Gazprom's position in Moldova.

Conclusions

- The delays in adopting the EU energy regulation in Ukraine, including the third package, require us to take a sceptical attitude towards the likelihood of their implementation. We can expect that only that part of the regulations which is good for big business will be adopted. In the current situation, Kyiv sees its membership in the Energy Community primarily as a bargaining chip in its negotiations with Moscow to lower gas prices. It is likely that Ukraine's withdrawal from the Energy Community will be one element in a package of future agreements with Russia, as the Ukrainian government has repeatedly signalled in recent months.
- Moldova is much further ahead than Ukraine in implementing the obligations of its membership in the EC, mainly in the electricity sector, and is interested in continuing their gradual introduction. The delays have been due to the recent political crisis, the inefficiency of the state administration, and to a large extent to the pressure from Gazprom, which is seeking to thwart the implementation of the third package in Moldova, and is making the signing of a new gas contract conditional on achieving this.
- The Energy Community has few legal instruments to enforce the implementation of the legal provisions which the member states are committed to. The organisation can only suspend its financial assistance (which Ukraine is not receiving now anyway because of its lack of progress in the reforms and suspend cooperation with the IMF. Without

political will from Kyiv and Chisinau, the EU's *acquis communautaire* in the energy sector will not be implemented.

Appendix

A list of Ukraine and Moldova's obligations from their membership of the Energy Community

Documents	Timetable	
	Ukraine	Moldova
Directive 2003/55/EC concerning common rules for the internal market in natural gas	By 01.01.2012	By 31.12.2009
Regulation no 1775/2005 on conditions for access to the natural gas transmission networks	By 01.01.2012	By 31.12.2010
Directive 2004/16/EC concerning measures to safeguard security of natural gas supply	By 01.01.2012	By 31.12.2010
Directive 2003/54/EC concerning common rules for the internal market in electricity	By 01.01.2012	By 31.12.2009
Regulation no 1228/2003 on conditions for access to the network for cross-border exchanges in electricity	By 01.01.2012	By 31.12.2010
Commission Decision 2006/177/EC amending the Annex to Regulation no 1228/2003 on conditions for access to the network for cross-border exchanges in electricity	By 01.01.2012	By 31.12.2010
Directive 2005/89/EC concerning measures to safeguard security of electricity supply and infrastructure investment	By 01.01.2012	By 31.12.2010

Directive 85/337/EEC on the assessment of the effects of certain public and private projects on the environment, as amended by Directive 97/11/EC and Directive 2003/35/EC	By 01.01.2013	By 31.12.2010
Directive 1999/32/EC relating to a reduction in the sulphur content of certain liquid fuels	By 01.01.2012	By 31.12.2014
Directive 79/409/EEC, Article 4(2), on the conservation of wild birds	By 01.01.2018	By 31.12.2017
Punkt 2 artykułu 4 dyrektywy 79/409/EC dotyczący ochrony dzikich ptaków	By 01.01.2015	By 31.12.2010
Plan for the implementation of Directive 2001/77/EEC on the promotion of electricity produced from renewable energy sources in the internal electricity market	By 01.07.2011	By 31.12.2010
Plan for the implementation of Directive 2003/30/EC on the promotion of the use of biofuels or other renewable fuels for transport	By 01.07.2011	By 31.12.2010