

Putin challenges Brussels to a gas duel

Szymon Kardaś

On 10 April, President Vladimir Putin sent a letter to 18 European countries (recipients of Russian gas transported via Ukrainian territory), in which he called for urgent consultations with Russia on the crisis in the Ukrainian economy and the security of gas transit through Ukraine. However, he threatened that the lack of a positive response would force Russia – in compliance with the gas contract signed in 2009 – to introduce a prepayment system for gas deliveries to Ukraine which, if Kyiv cannot meet them, may result in interruptions in gas supplies to European customers (as, according to Vladimir Putin, Ukraine could siphon off gas assigned to importers in Europe for itself).

The Kremlin's diplomatic gambit is not only a propaganda gesture. Russia is also trying to take advantage of the crisis to implement the key objectives of its gas policy regarding Ukraine: to take control over that country's gas infrastructure and maintain its position as the dominant gas supplier. It is possible that in the face of the problems in EU/Russian gas relations which have built up over recent years (such as the implementation of the Third Energy Package, and the European Commission's antitrust proceedings against Gazprom), Russia intends to use the Ukrainian crisis as an instrument to force the EU into strategic concessions which would lead to a substantial revision of EU/Russian energy cooperation. Although Putin's letter does not prejudge the suspension of gas supplies to Ukraine, it is very likely that Russia will not hesitate to do so if the European partners prove unwilling, at least partially, to take Russia's demands into account.

The propaganda narrative and the diplomatic trap

In listing the elements of Ukraine's drastic economic situation (including a gas debt which the Russian side estimates at up to US\$35.4 billion), Vladimir Putin has presented Kyiv as an unreliable partner, unable independently to meet its obligations. Putin blamed the European Union, in turn, for not taking a constructive approach to discussions on the effects of Ukraine's signing of the EU's Association Agreement; and for a trading policy which has led to adverse changes in Ukraine's trade balance (a Ukrainian deficit of US\$10 billion). Putin also stated that the solution to this situation is to hold urgent consultations, at the level of ministers of economy, finance and energy, in order to develop a joint plan to stabilise the economic situation in Ukraine and guarantee the security of gas transit through its territory.

This tendentious narrative concerning the Ukrainian economy ignores crucial factors which have had a significant influence on its condition for many years: the very disadvantageous gas contract signed in January 2009 on conditions imposed by Moscow (the price of gas, calculated for Ukraine on the basis of the contract price formula, was one of the highest in

Europe); as well as the high level of Ukraine's economic dependence on Russia, which makes it easier for the Kremlin to exert economic pressure, thus limiting Kyiv's room for political manoeuvre.

Putin's call for European countries to hold urgent consultations is an attempt to objectify Ukraine in Russia's relations with European states. This is part of a consistently pursued strategy to delegitimise the new Ukrainian leadership in Kyiv which has been in charge since the overthrow of President Viktor Yanukovich. The fact that the letter was sent to individual EU countries, and that the recipients did not include European Commission (which was only informed of the letter), is an illustration of Moscow's traditional strategy of conducting relations with EU countries in a bilateral format, rather than with the Union as a whole. It is also a diplomatic trap set by Russia for the EU. If the talks were held on Russian terms, the Kremlin would most likely take that as recognition of the truth of Putin's diagnosis of the situation, which would strengthen Russia's negotiating position. Any rejection of the Russian proposal will, in turn, be justified by Moscow as an excuse to resort to harsher economic measures against Ukraine (introducing prepayments for the gas settlement, and reducing or even halting gas supplies to Ukraine).

Russia's objectives in its Ukraine gas policy

The need which Putin has signalled to resolve the issue of transit of gas through Ukraine together with Russia's European partners reflects Moscow's traditional objectives in its gas policy towards Kyiv. These include the strategic importance of taking control of Ukraine's gas infrastructure (transmission networks and gas storage).

This is confirmed by, among others, the statement by Ivan Grachev, the head of the State Duma's energy committee, who suggested that Ukraine's gas debt to Russia could be remedied by giving Gazprom ownership of the Ukrainian infrastructure. Another acceptable variant for Moscow could be the creation of a trilateral Russian-Ukrainian-German gas consortium. The reactivation of this old idea is being considered in the context of an interparliamentary group on energy made up of representatives from the State Duma and the German Bundestag. Grachev, acting as co-president of the group from the Russian side, said on 24 March that the consortium's shareholders could be German energy companies, Ukraine's Naftogaz (or its legal successor) and Gazprom.

Although no details of any proposals to allocate shares in any possible consortium are yet known, we may assume that Moscow would seek to gain a controlling stake within it. The participation of German partners would make it easier to convince the government in Kyiv to agree to restructure Naftogaz and provide funding for the necessary modernisation of the Ukrainian grid.

Moscow may be hoping that the prospect of restrictions or interruptions in gas supplies to the EU (as a consequence of Ukraine siphoning off gas as a result of Gazprom introducing prepayments with Naftogaz, which Russia expects to happen) will persuade its European partners to put pressure on Kyiv to accept Russia's proposal.

If Russia took partial or complete control of the transmission infrastructure, this in turn would allow it to implement another important goal: that of maintaining its position as the dominant supplier of gas to Ukraine, and to counteract any attempts to diversify sources of

supply. This is particularly important in the context of recent consultations between Ukraine and Slovakia on the possibility of initiating reverse gas supplies from the European Union to Ukraine; Naftogaz's talks with the German company RWE and the French GdF as potential alternatives gas suppliers to Gazprom; as well as Ukraine's plans for the extraction of shale gas.

The Ukrainian crisis as a pretext to revise gas cooperation with the EU

The increase in tension in Russian/Ukrainian gas relations may be important in the context of energy problems between Russia and the EU.

Moscow considers the implementation of the Third Energy Package in EU countries as a political tool by Brussels to fight Gazprom, and as an 'unnecessary' obstacle to the full implementation of strategic Russian energy projects, principally Nord Stream and South Stream. In the first case, at the beginning of March, the European Commission postponed the date for the decision to allow use of the full capacity of the OPAL pipeline, which is a land extension of the Nord Stream (the final decision should be taken in the next few weeks); this would mean a failure to uphold the decision of the German regulator allowing Gazprom to use the full capacity of the OPAL pipeline, and by extension the Nord Stream. In the second case, the EC has called into question whether the bilateral agreements concluded by Russia with the countries through which the South Stream pipeline is to pass are in compliance with EU law; Russian/EU negotiations on this issue are being conducted by a special expert-level working group.

The Kremlin has also been critical of the antitrust proceedings being carried out by the European Commission against Gazprom since September 2012; the first phase of the proceedings – which will probably be unfavourable for the Russian company – should be completed before the end of this spring.

It cannot be ruled out that the threat of another gas crisis in relations between Russia, Ukraine and the EU will be used by Moscow as a pretext for a more assertive expression of its postulates (which it has put to Brussels over the last few months) to revise energy cooperation between the EU and Russia, the main component of which is an exemption from the application of EU regulations to cross-border projects (mainly South Stream and Nord Stream). Russia's expectations in this area have been repeatedly declared in public statements by Russian government representatives, as well as in specific diplomatic proposals (in 2012, Russia twice sent Brussels a draft agreement which would have comprehensively regulated the issues of cross-border EU-Russian cooperation in the energy sector).

Conclusions

Although President Putin's letter does not assume the interruption of gas supplies to Ukraine, by signalling the possibility it proves that Russia is ready to take such a step, if its European partners prove unwilling to offer a 'constructive' response which would take Russian demands into account.

Reducing or stopping the gas supply would indeed risk some economic costs for Russia, related to a drop in profits from deliveries to European customers and the need to pay compensation in the event of any claims from European customers (the Russian/Ukrainian gas crisis in 2009 reduced Gazprom's profits from supplies to Europe by US\$1.1 billion); in the long-term, it could also worsen Russia's strategic position on the European market (another gas crisis would reinforce the determination of the EC and the majority of member states to accelerate the diversification of supply sources onto the EU market and reduce their dependence on imports from Russia).

However, given Europe's current high level of dependence on Russian supplies (in 2013, Russia reached a record 30% share of the European market), and the limited opportunities for EU consumers to diversify their gas sources over at least the next 3-4 years, Moscow may decide to opt for confrontation, especially when the prospect of achieving its strategic policy objectives in its relations with Ukraine and the EU is at stake.