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Research Report

Gas once again a bone of contention between Russia and Ukraine

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Heli Simola and Laura Solanko

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Heli Simola and Laura Solanko

Gas once again a bone of contention between Russia and Ukraine

Abstract

Ukraine is afraid of Russia cutting off its gas supplies if it cannot pay the higher price demanded by Gazprom. However, the situation is not an easy one for Gazprom, either, Ukraine being one of its largest customers and an important transit route to European customers. Most EU countries would be unlikely to face major difficulties from possible short-term disruptions in the availability of gas imports.

Keywords: Russia, Ukraine, energy

Gazprom announced substantial gas price hikes for Ukraine

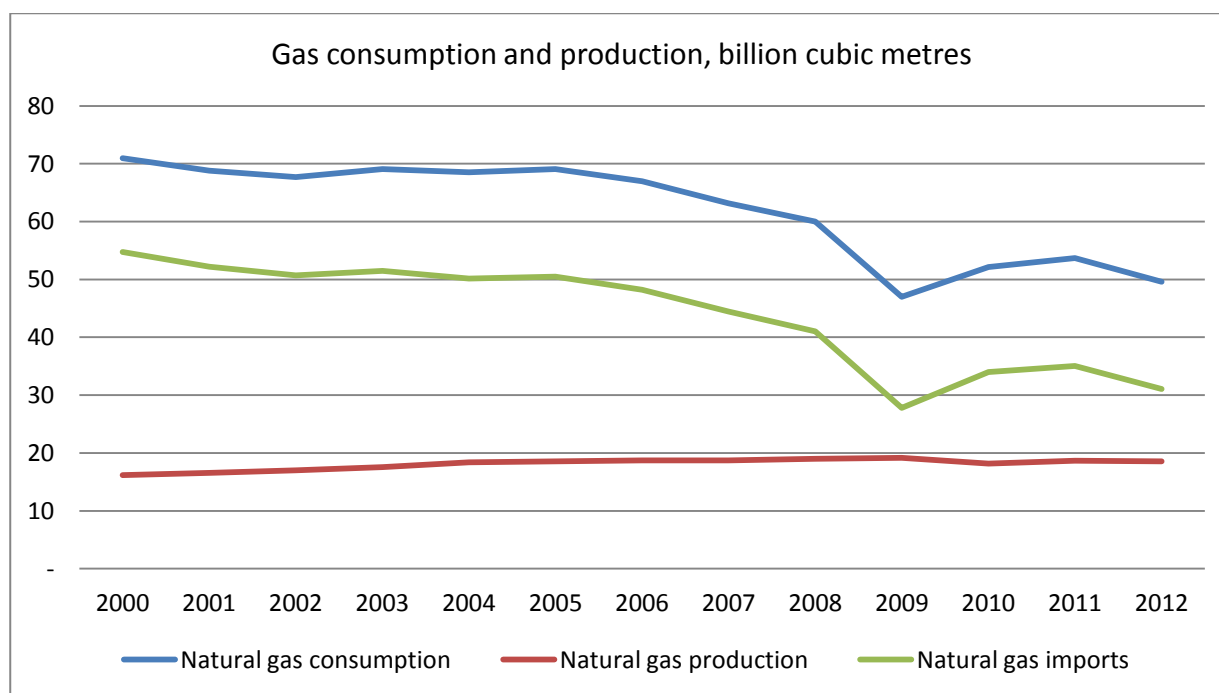
The Russian gas company Gazprom announced in early April that it would raise the price of gas supplied to Ukraine to USD 485 per 1,000 cubic metres; this contrasts with USD 268.5 per 1,000 cubic metres earlier in the year. Gazprom decided to cancel previously granted discounts because of Ukraine's state energy firm Naftogaz being in arrears with payments and owing USD 2.2 billion in unpaid bills. The price now charged to Ukraine is considerably higher than Gazprom prices charged to EU countries; for example, the average price paid by Germany for gas this year is USD 380 per 1,000 cubic metres.

According to Gazprom, the new price is based on the 10-year agreement made between Gazprom and Naftogaz in 2009, under which the price of natural gas sold to Ukraine is determined by the market price of oil, among other factors. In recent years, however, the actual price has ultimately been negotiated between political decision-makers and has been affected by a variety of diverging factors, such as compensation paid by Gazprom for gas transit and natural gas storage and the leasing agreement for the Sevastopol naval base.

Ukraine afraid of supply cuts, but situation not easy for Gazprom either

Ukraine has announced its inability to pay its higher gas bill without external financial assistance. Gas imported from Russia accounts for about a fifth of Ukraine's total primary energy consumption and about 60% of its natural gas consumption (Chart 1). Ukraine itself produces the rest of the gas it consumes, with output concentrated mainly in the regions of Kharkov and Poltava in eastern Ukraine. Of the natural gas consumed in Ukraine, half is used by households and the public sector, which can buy gas at markedly lower government-subsidised prices. Ukraine is now afraid of Russia cutting off its gas supplies, as it did during the price disputes in 2006 and 2009.

Chart 1. Ukraine's natural gas consumption and import needs have contracted significantly



Source: BP.

However, the situation is not an easy one for Gazprom, either, Ukraine being one of its largest customers. According to some analyst assessments, the price increases already announced could even reduce the value of Gazprom's sales to Ukraine, as they would erode demand so strongly. Moreover, if Gazprom were to suspend sales to Ukraine, such an action could also hamper its deliveries via Ukraine to EU countries and Turkey, as in 2006 and 2009. Around a third of Gazprom's sales volume and about half its earnings are derived from exports to these countries.

Most EU countries unlikely to face major difficulties from possible short-term disruptions in gas imports

Natural gas accounts for a good fifth of primary energy consumption in the EU28, with imports from Russia representing roughly the same proportion of gas consumption. Consequently, about 5% of the EU28's primary energy consumption is covered with Russian natural gas, of which less than half is transported via Ukraine. EU countries' current stocks of gas equal around two months' use, their LNG import terminals are underutilised and the heating season is nearly over (Table 1). Therefore, most EU countries would be unlikely to face major difficulties from short-term disruptions in the availability of gas imports from Russia. If imports were to be disrupted over a longer period of time, significant problems could emerge only at the beginning of the next heating period (October-November).

The differences across countries are, however, fairly considerable, and district heating in eastern Central Europe, in particular, and household gas are those forms of natural gas consumption in the EU that are most difficult to find a substitute for. In addition, Russian gas is imported to eastern Central Europe almost entirely via Ukraine. Of the EU countries, Slovakia, Hungary, the Czech Republic and Bulgaria are the most vulnerable to disruptions in gas transit via Ukraine. In recent years, however, Slovakia and Hungary have built reverse flow facilities for gas pipelines, meaning that gas can be imported from Germany to these countries, if necessary.

All natural gas consumed in Finland is imported from Russia, but via an independent separate pipeline. Nor is natural gas an immensely critical fuel for Finland's energy consumption, as it is not used by households to a significant extent, and public utilities can switch to using substitute fuels. The Baltic countries also import all their natural gas direct from Russia, but in these countries natural gas is a fuel that is much more important and harder to replace than in Finland. Natural gas imports from Russia to other EU countries are also routed via Belarus and through the Nord Stream pipeline on the Baltic seabed.

Table 1. Share of natural gas in energy consumption in 2012

	Share of natural gas in energy consumption	Share of Russian natural gas in energy consumption	Share of natural gas imported via Ukraine in energy consumption	Sufficiency of gas stocks in early April 2014, days*
Netherlands	37%	2%	0%	4
Belgium	25%	11%	0%	15
Bulgaria	14%	14%	14%	35
Spain	20%	0%	0%	19
Ireland	31%	0%	0%	n.a.
Italy	38%	8%	8%	46
Austria	25%	13%	13%	75
Greece	13%	7%	7%	n.a.
Latvia	15%	15%	0%	n.a.
Lithuania	36%	36%	0%	n.a.
Portugal	19%	0%	0%	12
Poland	15%	8%	0%	28
France	16%	3%	1%	25
Romania	36%	16%	6%	n.a.
Sweden	2%	0%	0%	0
Germany	22%	9%	6%	64
Slovakia	32%	20%	20%	147
Finland	10%	10%	0%	0
Denmark	21%	0%	0%	46
Czech Republic	18 %	14 %	14 %	94
UK	35%	0%	0%	11
Ukraine	39%	21%	-	n.a.
Hungary	40%	20%	20%	60
Estonia	10%	10%	0%	0

*calculated from monthly consumption in 2012

Compiled from a range of sources: Eurostat, BP, Gazprom, Gas Infrastructure Europe, Oxford Institute for Energy Studies.

(n.a. = no data on stocks available)

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