

# Ukraine *versus* Russia: the real story

The gas conflict between Ukraine and Russia is not what it appears to be in the western media, argues Jérôme Guillet. It has been going on for at least 15 years and it is really a war between private parties in Russia and Ukraine who engage in illicit gas trading.



Photo: Sergei Supinsky/AFP/Getty Images

| by Jérôme Guillet

The gas conflict between Russia and Ukraine has garnered much media attention, but there are some points worth underlining. Firstly, these conflicts have been going on for longer than is generally understood. Secondly, Russia knows it cannot win a gas war against Ukraine. And finally, the underlying stakes are not really about Russia or Ukraine as national entities.

It's generally assumed that these spats began in 2006, but in fact Russia and Ukraine started squabbling about gas as soon as the Soviet Union broke up. There were cuts to gas deliveries to Western Europe in 1992 and 1993, which led the major importers – Gaz de France (GdF), Ruhrgas, SNAM – to set up offices in Kiev to get local input and be able to lobby the new Ukrainian government in favour of continuity of gas supply.

I spent six months in GdF's Kiev office in 1994, where I collated local sources for a report on the Ukrainian gas industry, and picked up content for my PhD dissertation on the independence of Ukraine and its relations with Russia, both of which were defined largely by gas. I've never been able to ascertain that Ukraine actually ever paid anything for gas to Russia then or since.

Ukraine was the birthplace of the Soviet gas industry in the 1930s, and the infrastructure was built from there. The focus of activity later moved to Western Siberia, but Ukraine remained central to the pipeline network. The split-up of the Soviet Union made for an often unworkable allocation of physical assets, and nowhere was this more true than for gas. Gazprom

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lost direct control of vital assets located in Ukraine.

The gas-industry ties between the two countries are inextricable and highly constraining. In case of conflict, the temptation to use the "gas weapon" (in the case of Russia, by withholding gas or, in the case of Ukraine, by withholding export infrastructure) is strong – and has been repeatedly yielded to until, each time, compromise is reached.

If you were to go back over Ukrainian and Russian newspapers from any date over the past seventeen years, you would find articles about unpaid Ukrainian debts for gas (which, since 1992, have for some reason always been in the \$1.5-2 billion range), and bilateral brinkmanship. Yet somehow the gas continues to flow every year.

#### Democratic world |

So why do we have the impression the conflict started only in 2006? Well, it's just that we started to care that year, for some obvious reasons. The 2004 "Orange Revolution" put Ukraine on the map, as a new, spunky member of the "democratic world" against the axis of evil and other assorted dictatorships, a group that Russia was beginning to join in the White House view. Never mind that Yushchenko was initially more pro-Russian than Yanukovich, hardliners in both the US and the Kremlin were happy to play this as a West vs Russia fight. The arcane gas disputes that only a few buyers cared about began to be presented as the battlefield between two large blocs.

The rise in oil prices since 2003 has had an impact on gas prices (Russia's gas prices are indexed to oil prices) and has increased the profile of energy-related issues. More importantly even, 2006 is the year when the UK became (it seems unexpectedly for its political leadership), a gas importer rather than exporter. Suddenly, for the first time, security of gas supply became an issue for English-language experts. Europe's dependency on Russian gas and Ukrainian transit was portrayed as crucial – never mind that Western Europe has been importing Russian gas for forty years and that companies like GdF and Ruhrgas have been aware of the delicate situation of Ukrainian transit since the early nineties.

About then, too, ten Central and Eastern European countries joined the EU. As the majority were former Soviet satellites or Republics, they are wary of Russia and most of them are highly dependent on Russian gas, because their supply infrastructure was built in the context of the Comecon. While they are not all

in the same situation, they have certainly encouraged the EU to sharpen its focus on Russian gas supplies.

While these factors help explain why it's not unreasonable to care more today than in the past, there is no excuse for not providing relevant context to the conflict, i.e. that this is a long, simmering dispute that is not about big-bloc politics, and has little to do with the West.

#### Co-dependency |

What media accounts have been failing to relate is simply what this conflict springs from in the first place. Ukraine has a lot of vital Soviet-times gas infrastructure. The pipelines of course, but, just as significantly, Ukraine controls most of the storage capacity of the Russian export system, something rather important when you know that winter gas demand is 2-3 times summer demand and pipelines can be made smaller if you can ship gas all year long and store it close to markets for winter use. It is also a heavy-industry country, with very high gas demand. It has also mostly depleted its own gas reserves. So mutual dependence is high. Russia needs Ukrainian infrastructure to honour its export contracts, and Ukraine needs Russian gas. In the early years, there were additional constraints, such as the only Soviet manufacturer of large pipes used by Gazprom being in Ukraine, the only manufacturer of medium sized pipes (needed by the Ukrainians) being in Russia, and gas going to Southern Russia needing to flow through Ukrainian territory.

Ukraine used to get its gas allocation from Soviet planners, and continued to expect the same after independence. When Russia first tried to get payment for its deliveries in the early 90s, it failed; when it first cut off gas to Ukraine to enforce payments, Ukraine simply tapped the gas sent for export purposes in Ukrainian-controlled pipelines. When European buyers squawked, Russia relented and restored gas supplies without having managed to get paid by Ukraine. This happened repeatedly in 1992-1994 and later as well, though both sides learned to give their disputes a lower public profile.

What happened in 2006 was fundamentally the same, the change being that the dispute was thrust into the limelight. Continuity can be seen in the striking fact that in January 2006, Russia restored deliveries before an agreement was announced. This was mostly overlooked in Western coverage of the crisis, as was the fact that the announced agreement did not stand

up to scrutiny – everybody should have realised it was a sham. The price Russia claimed to be getting and the price Ukraine agreed to “pay” were not compatible, even with the inclusion of ultra-cheap gas from Turkmenistan – and nobody asked why Turkmenistan should agree to such a low price.

Russia cannot cut off Ukraine for any substantial period of time, because that endangers its exports and Gazprom knows it perfectly well. Another hard fact is that, in practice, giving roughly 20% of its gas shipments to Ukraine as a quid pro quo for transit (over an average of more than 1,000km) is an acceptable transaction for both sides. Of course, when gas prices rise, as in recent years, it is tempting to try to change the conditions of trade, but Russia has no practical way of enforcing it. So, in this year's dispute, Gazprom demands a higher price for gas supplied to Ukraine, but offers higher rates for transit; on balance, there is no change.

This gives rise to a fair question: why on earth does Russia go in for this pluri-annual drama? I have a simple theory: it's a charade, a distraction from what's really at stake.

#### Private trade |

Gazprom's leadership long ago understood that it could not get any money out of official deliveries to Ukraine. It “solved” that problem by privatising a portion of the gas trade to Ukraine – that portion going to customers able to pay for their gas. These customers used to pay the central Ukrainian gas company, which did not pass that money on to Gazprom. A mechanism was set up whereby these customers were offered a cheaper rate for their gas if they directly paid another supplier, formally unrelated to either Ukrainian gas authorities or Gazprom.

Of course, only gas coming from Russia could be delivered, and it still needed to use Ukraine's gas infrastructure, so the trade could not be organised without the cooperation of Gazprom

and senior Russian and Ukrainian people – but the money generated did not need to go to either Kiev or Moscow. Thus the powerful figures that enable (and therefore, can disable) the trade, can personally benefit from it – and cut out both Kiev and Gazprom.

This is juicy business, and that attracts others keen to get in on the action. In Ukraine, political infighting can largely

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be understood, in my view, by the fight over who will be the Ukrainian counterparty to that trade. It's no coincidence that Yulia Timoschenko made her fortune in gas trading in the 90s, and that Yanukovich represents some of the largest gas-users from heavy industry in Eastern Ukraine. In Russia, similarly, one has to go beyond the image of a monolithic Kremlin with its faithful Gazprom arm – both are rife with infighting, and coalitions within each of these centers of power come and go. Vladimir Putin's decision this year to halt gas supplies from Russia to Ukraine, an unnecessary call that lay Russia open to international finger-pointing as the villain of the piece, may well have been taken under the pressure of factions between which he is not able to arbitrate.

So while the world focuses on the public brinkmanship between Ukraine and Russia, the real fight over the spoils takes place more discreetly between a few oligarchs in Moscow and Kiev. But nobody talks about that, which is the whole purpose of the show we are offered.

Worries about Russia or Gazprom deliberately using the “gas weapon” against Europe are misplaced. Both are too aware of their absolute dependence on exports to Europe, and on the need for stable long-term relationships to finance the investments needed in infrastructure, to threaten their customer base. They are happy to play power politics with the West's worries as this goes down well with their own domestic audiences, but fundamentally they will not rock the gas boat.

What is a lot more worrisome is that governments in Ukraine and Russia can tolerate such blatant breaches of their authority and such large scale theft of what are effectively public resources. That the highest levels of government in both countries can be instrumentalised in disputes between faceless oligarchs only shows how little the rule of law and principles of accountability have penetrated these countries, and how relative is Putin's power when dealing with competing factions. ■

## Who is Jérôme Guillet?

*Jérôme Guillet works as investment banker in Paris. He is editor of the European Tribune. He has published about the Russian-Ukrainian gas conflict for the Institut Français des relations internationales (IFRI). John Evans, an editor at the European Tribune, helped write and edit this article.*

