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Keith Johnson

## **Putin Aims His Energy Weapon At Ukraine**

**Moscow is jacking up gas prices to cow Kiev and scare Europe. It may not work this time.**



Secretary of State John Kerry has accused Moscow of using ham-handed covert operations to destabilize eastern Ukraine. Russia is making no attempt to hide its latest assault on Ukraine: a sharp spike in natural gas prices designed to bring the cash-strapped country to its knees.

Russian President Vladimir Putin raised the prospect Wednesday of making Ukraine pay in advance for the natural gas that it buys from Russia, a potentially ruinous move for the credit-challenged Ukrainian government. Ukraine's total gas debt to Russia now totals more than \$16 billion, Russian officials said.

While Putin reportedly ordered Gazprom, the big energy giant, to wait until another round of talks with Ukraine before implementing the move, the threat of making Ukraine pay upfront for its gas will become Moscow's default stance if the talks fail. Some U.S. lawmakers, such as Rep. Michael Turner (R.-Ohio.) seized on Russia's latest saber rattling to reiterate calls for the United States to expedite the export of natural gas to countries such as Ukraine.

Kiev, meanwhile, took the pre-emptive move of halting its imports of Russian natural gas until the two countries can resolve a contentious dispute over prices. Moscow has jacked up the price it charges Ukraine twice in recent days by a total of more than 80 percent, making gas sold to Ukraine among the priciest in Europe.

In a brazen display of chutzpah, Moscow justified the second price hike after abrogating a 2010 treaty between the two countries. Under the terms of that so-called Kharkiv accord, Moscow offered price discounts to Ukraine as a lease payment for the Russian naval base in Sevastopol, on the Crimean Peninsula. Now that Russia has forcibly annexed Crimea and taken over the naval base, it argues that discount no longer applies.

Ukraine's prime minister called the price hikes "economic aggression," and the government is considering taking the dispute to international arbitration. One senior Russian state energy analyst suggested Wednesday that the price hike is meant to pressure the European Union into approving South Stream, a Russian-led pipeline that would ship gas from Russia to

Europe, bypassing Ukraine entirely. The European Union has said it will halt talks on the pipeline until the Ukrainian crisis is resolved.

For now, Ukrainian Energy Minister Yuriy Prodan and other top officials say that they consider the old, fully-discounted price for gas of about \$268 per thousand cubic meters to still be valid, and have offered to make their payments based on that formula. Moscow says the new price is \$485.50 per thousand meters. That works out to \$15.18 per million British Thermal Units, far higher than what is paid by other European countries. Russia charges Germany, for instance, \$10.69 per MMBTU. The German spot market price for natural gas is \$8.47, while the U.S. spot price for gas is just \$4.56, according to calculations made by Mikhail Korchemkin, founder of East European Gas Analysis, an energy consultancy based in the U.S.

Russia's energy relations with Ukraine matter, because Russia remains the largest supplier of Europe's natural gas and Ukraine remains the main transit point for that gas to get to customer countries such as Germany. Russian media stressed remarks by Ukrainian energy officials that gas shipments to the rest of Europe could be affected by the dispute, underscoring longstanding Russian arguments that they need a way of bypassing Ukraine so Europe isn't dependent on its pipelines.

But while worries about another energy crisis do rattle European diplomats, especially those in central and eastern Europe most dependent on Russian supplies, times have changed.

"This is not 2009," said Carlos Pascual, the head of energy diplomacy at the U.S. State Department, in a speech last week.

Previous gas crises between Russia, Ukraine and Europe came in the dead of winter, when gas demand was at its highest; today's crisis is unfolding after an unseasonably warm winter and with spring already here. That means that Europe has natural gas in storage, and natural gas demand will remain low for the next six months.

What's more, Pascual noted, the last crisis prodded Europe to take steps to make its energy markets more resilient to sudden supply shocks. "After 2009, the European Union went into hyperdrive" to reform its natural gas markets, he said. That includes making it easier for European countries to ship gas to each other in times of need, an issue that has come to the forefront in the current showdown between Moscow and Kiev.

Countries such as Hungary and Poland can already ship small amounts of natural gas to Ukraine, or about enough to meet seven percent of Ukraine's annual demand, or about 25 percent of its lower summertime demand. Reversing pipeline flows from Slovakia to Ukraine would add twice that amount -- but would also require the construction of a new pipeline, because Gazprom has bought transit rights on the main Slovak pipeline for years to come.

Given seasonally low demand for gas, relatively healthy gas storage levels, and the possibility of importing some additional gas from alternative suppliers such as Norway and Algeria, some believe Europe is actually well placed to turn the energy weapon around on Russia by halting its purchases of Russian gas. That would put severe pressure on Moscow, which is reliant on gas and oil exports for more than half of its federal budget.

"If Russia moves into eastern Ukraine now, Brussels should impose an embargo right away," Korchemkin said. "The closer it gets to the winter, the more painful the gas embargo would be for the EU," he said, estimating that Gazprom and the Russian government could wind up losing \$100 million a day.

To be sure, Europe's ability to shake off reliance on Russian gas supplies is limited in the short term, and by next winter Russian energy will be important for meeting European power and heating needs. Making pipelines reverse their flow of gas would cost millions of dollars and take months to build. U.S. supplies of natural gas won't materialize until nearly the end of the decade, and Europe would likely have to pay more for imported gas by tankers than it currently pays Russia.

"I find European optimism misplaced and foolish, because it potentially jeopardizes stable and long lasting trade relations," said Tim Boersma, an energy expert at the Brookings

Institute. "Joining the American calls to isolate Russia may sound like an attractive idea, but it comes at a high cost, and Europe will pay it--not the U.S."