



## Perspective on Natural Gas Crisis between Russia and Ukraine

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### Abstract

In 2009, the natural gas dispute between Russia and Ukraine was clothed with the name of “Natural gas crisis” and “Cold War” due to its long-time lasting and extensive spreading sphere. Under the circumstances when the financial crisis plagued the whole world, Russia and Ukraine suffered from the financial crisis, Ukraine was going to begin its Presidential election, and internal political struggle began to heat up, the natural gas dispute was attached extraordinary political and economic meanings. In view of the superficial natural gas price and debt struggle, we can find out that political and economic wrestle behind was the actual reason for outbreak of the natural gas crisis between the two countries. In this article, the author will try to make a deep analysis in different standpoints and strategic consideration of the relative parties of the natural gas crisis, namely, Russia, Ukraine, European countries and America.

**Keywords:** Russia, Ukraine, Natural gas crisis

After the “disagreement” of Russia and Ukraine in 2006, the natural gas dispute between these two countries came on again in 2009. However, this “disagreement” differed from that former one because of its long-time lasting and extensive spreading sphere. In November 2008, a dispute took place between Russia and Ukraine due to debt and gas supply price. On January 1, 2009, Russia completely broke off gas supply to Ukraine, and affected gas supply to several EU countries. Afterwards, with urgent mediation and several negotiations of EU, the two parties finally signed a 10-year gas supply deal. Russia agreed to give a 20% discount to Ukraine on the basis of the price of gas supply to Europe, while Ukraine agreed to maintain the rate of gas transmission to Europe that passed through Ukraine in 2009 the same as that in 2008. From January 1, 2010, calculation of gas supply price and rate of transit gas transmission between Russia and Ukraine will be in total accordance with European pricing. In terms of gas supply fee settlement, the two parties will exclude an intermediary agency. So far, the natural gas crisis which has been lasting for approximately 20 days has finally come to a stop. Yet thinking caused thereby never stops. Why Russia and Ukraine fight for that at the cost of their economy and international image when the financial crisis plagues the entire world and these two countries suffers from the financial crisis? What’s the standpoint and strategic consideration of the relative parties of the natural gas crisis, namely, Russia, Ukraine, European countries and America? In this article, the author will try to make a profound analysis.

### 1. Political and economic consideration of Russia

#### 1.1 Financial crisis behind the gas crisis

Under double attack of financial crisis and steep fall of international oil price, the Russia economy that had been developed with a fast speed at one time began to “hard land”, and all items of economic indices deteriorated day by day. Since the second half year of 2008, Ruble has been devaluated greatly. Compared with the historical high value of the exchange rate of 1 dollar to 23.4 ruble, the range of price drop of the exchange rate of ruble to dollar at present has

exceeded 40%. Originally, dependency of Russia economy on foreign capital has been high, together with flight of a large amount of capital triggered by financial crisis, the total amount of capital flight in 2008 was up to \$ 130 billion. Besides, foreign exchange reserves in Russia also shrank greatly, and it was estimated that foreign exchange reserves in 2009 might be reduced to \$ 400 billion. Simultaneously, Russian banks and enterprises was in high foreign debt, with a serious shortage of fluidity, so it was encountered with job displacement and a reduction in production. The GDP of Russia in January 2009 reduced by 2.4% over the same period of 2008, a negative economic growth had happened for two months, and meanwhile the population of unemployment had been on the increase. According the report issued by international rating agency, it was estimated that export of Russia in 2009 might shrink by 25%, its GDP might be reduced by 2.2%, its industry might slide down, its property market and stock market might be seriously frustrated, and the phenomenon of unemployment would get more serious. All this has been an actual portraiture of the current domestic situation in Russia. The Russian “economic train” stimulated by “oil dollar” has displayed a weak and tired condition of progress. Furthermore, Gazprom that has controlled the forces in the international energy market has also had a hard time. Since the attack of financial tsunami, Gazprom’s market value of shares has reduced by 3/4, and its debt was up to 40 billion Euro. Profits of the enterprises have descended, in urgent need of investment. However, under the circumstance of current credit crisis, financing is quite difficult. Therefore, financial crisis has made both Russian Government and Gazprom strapped for cash. From this perspective, the direct reason for the “disagreement” of Russia is money.

## *1.2 Fight for control power of energy geostrategy*

### *1.2.1 Control power of Ukrainian natural gas pipeline*

Ukrainian natural gas pipeline is one of the largest transportation systems in Europe which is second only to that of Russia, and is an important hinge for connecting European major production regions and consumption regions of natural gas, so it has a strategic significance. At present, except for Yamal-Europe Pipeline, all natural gas pipelines from Russia to Europe pass Ukraine. Each year, Russia delivers to Europe approximately 120 billion cubic meters of natural gas through pipelines of Ukraine, which accounted for about 80% of the total amount of natural gas from Russia to Europe. Ukraine controls the key channels of natural gas exported from Russia to Europe, so it often threatens Russia by increasing rate of gas transmission and even by “cutting gas”, for which Russia has always been deeply concerned. As a matter of fact, as early as in 2002, Russia and Ukraine signed a deal for co-managing and developing their natural gas transportation system. However, rising to authority of Viktor Yushchenko made this project come to an untimely end. Control of Ukrainian natural gas pipeline has always been perplexing Russia for quite a long time. During the period of natural gas crisis, the President of Russia Putin and the President of Gazprom Miller respectively expressed that, Russia planned to research and take part in the privatized process of Ukrainian natural gas transportation system.

### *1.2.2 Right to decide the price of energy*

In recent years, high price of international energy has brought a huge sum of wealth to Russia. Putin made an outright statement that the export of energy helped Russia rise. However, the role Russia has been playing is still a game participant, but not a rule maker. This determines its high dependency on other countries of Russian energy price and the great uncertainty. The financial crisis and frustrated oil price made Russia more desperate to participate in formulating rules of the energy market. On January 19, 2009, the final result of the natural gas deal between Russia and Ukraine enabled Russia to acquire the right to decide price of its natural gas, and also the right in terms of the rate of transit gas transmission. In addition, Russia shifted earlier the deadline of the transition period of pricing originally determined, which was in line with Russia’s standpoint to adopt the market pricing as soon as possible. Without doubt, this has been a victory for Russia, and it can also be regarded as another effort made by Russia in recent years to improve its right to decide the international energy pricing.

### *1.2.3 Control power of Post-Soviet space*

Since the “Orange revolution” in Ukraine in 2004, the progress of Ukraine to break away from Russia and to join in Europe has been quickened, which has caused strong response of Russia. Since 2008, the pro-western standpoint of Ukrainian leaders have been more definite. They volunteered to join in NATO, and supported Georgia during the Russia-Georgia Conflict and provided weapons to Georgia, which accumulated more rancor between Russia and Ukraine. Since Ukraine goes further from Russia, Russia threatens and punishes Ukraine by means of “cutting off the

natural gas supply". And Russia also warns other independent states of Commonwealth that have the same tendency that, if they continue to carry out the pro-western policy, and if they don't abide by the rule formulated by Russia in the Post-Soviet Space, then they won't hope for the "favor" of Russia. Since the Russia-Georgia Conflict, Russia has further regarded the Post-Soviet Space as the priority area for its imposing of any influence. With its increasingly strong national power, Russia gets back its confidence of Great Power, and the control power of Post-Soviet Space is a necessary choice for Russia to realize its geostrategic interests.

## **2. Domestic political fight in Ukraine**

Financial crisis has seriously attacked Ukrainian economic system. The current Ukrainian inflation rate is up to 100%, and its monetary exchange rate to the US dollar is also devaluated by half. Furthermore, Ukraine is faced with such difficulties of reduced industrial production, increased unemployment population, serious shortage of foreign exchange. As the originally second largest Economy in the entire Soviet Union, Ukraine was seriously short of farm products, and became one of the first countries to put forward application for assistance to IMF. In such an economic situation, it was without doubt that intensification of the natural gas dispute would add more difficulties to Ukrainian economy which had been originally difficult. Then, why did Ukraine challenge Russia, and "act rashly" against Russia? Political fight within Ukraine was the catalyst of the natural gas crisis, and both the President Viktor Yushchenko and the Prime Minister Tymoshenko intended to gain their political capital through this natural gas dispute. Yushchenko's persistence of enlarging the dispute was a speculative trial to get Ukraine to join in EU and NATO.

During the "Orange revolution", Ukraine was in a split condition, and the relation between the president and the prime minister deteriorated. Since September 2007 when the Tymoshenko alliance led by the Prime Minister Tymoshenko and the "Our Ukraine-People's Self-Defense" led by the president constituted the governing coalition, internal contradiction within the coalition got rapidly acute, and the two parties were diametrically opposite in terms of economic policy and foreign affairs. Influences of the forthcoming 2009 presidential election and the financial crisis on Ukraine became gradually manifest, and internal fight within Ukraine turned white hot. Under attack of the financial crisis, political and economic crisis of Ukraine was forced to approach its critical point. The financial crisis firstly attacked prestige of the President Yushchenko. If we say that favorability rating of Yushchenko during the "Orange revolution" surpassed 60%, then the current rating is less than 5%. Party of the Regions and Communist Party of Ukraine publicly expressed in the Parliament that they would impeach the President. However, Tymoshenko challenged authority of the President in virtue of his flexible internal and foreign policies. Domestic political fight within Ukraine would directly affect the problem of natural gas. During the natural gas dispute, internal political top leaders of Ukraine couldn't speak in one voice, because natural gas was regarded as the natural bargaining chip of political confrontation. Each group of Ukrainian regime intended to obtain their own economic interests, including transporting and supplying natural gas of Russia to Ukraine. With different economic interests, it was impossible to get a political consensus. As for Ukraine, natural gas was a potent political resource utilized by the President Viktor Yushchenko and the Prime Minister Tymoshenko. Both of them didn't want to give up this trump card during the political fight, and both wanted to win "popularity" of election through "disagreement". However, this "disagreement" obviously interrupted resolution of the natural gas dispute. The Russian President Putin and the Ukraine Prime Minister Tymoshenko signed a gas supply deal of \$ 250/1000cms in October 2008, but immediately, the President Viktor Yushchenko interfered by proposing the requirement that the price of 1 thousand cubic meters of natural gas should not surpass \$ 201. In face of the crisis, each group in Ukraine sought to gain a score in terms of politics, which was even more urgent than resolution of the crisis per se. Besides, the extraordinary action of Ukraine to get close to Europe during this natural gas crisis was, on one hand, to inflict pressure upon Russia, and on the other hand, to add its negotiation weight in future negotiation with EU.

## **3. Neutral standpoint of EU**

Different from the hard attitude of European reproval on abuse of energy weapons by Russia three years ago, EU tried to avoid attaching the "Business dispute" between Russia and Ukraine any political color, and refused repeatedly to be an intermediary and conciliator. However, with sudden escalation of the natural gas dispute on January 7, the natural gas transported to Europe by Russia through Ukraine was totally cut off, which caused 18 European countries to suffer from difficulties without gas. EU believed that, the incident had transferred from the bilateral trade dispute of Russia and Ukraine to a political issue of Europe, Russia and Ukraine, so EU had to change its indifferent attitude several days

ago and was engaged in active conciliation between Russia and Ukraine. EU really had no choice from not intending to get involved to being enforced to get involved.

Pan-Europeanization of the natural gas issue between Russia and Ukraine caused all relative EU countries to be “hostage” of this crisis, and simultaneously hit the “soft rib” of EU energy once again. One fourth of EU’s natural gas was imported from Russia, among which 80% was transported through Ukraine, so energy security of EU seemed fragile during this disturbance. After the natural gas dispute that took place 3 years ago, EU promised not to be subject to the natural gas dispute any more. EU had planned to add energy supply sources and transportation pipelines, and appealed to its member countries to increase their natural gas stock. However, within the 3 years, essential measures that EU achieved have been not enough. As a matter of fact, EU doesn’t have many choices. EU is quite aware that, its energy dependency on Russia in the foreseeable future will not be weakened, but instead, will be further strengthened. Therefore, EU doesn’t want to affect the essential relations between Russia and EU because of the issue of “gas cut”. However, “gas cut” triggered the vital interests of EU to a great extent, so EU can’t but see to this issue. Therefore, EU has no other choice but to select the conciliation of a difficult neutral route.

Perennial natural gas “controversy” between Russia and Ukraine caused great hardship to EU. In “Sueddeutsche Zeitung”, German reported with no choice that the project of Russian natural gas pipeline was a typical dependency of Europe on Russia, and this was a “constructional mistake” for Europe. On January 12, Secretary of Energy in EU presided over an extraordinary session in Brussels, and assessed serious results of “disagreement” between Russia and Ukraine on EU member countries. He decided to realize diversification of energy sources within a long and middle term of period and to ensure energy security. However, before realization of the diversification by EU, it is EU that is in a passive position during the “natural gas war” between Russia and Ukraine.

#### **4. Geostrategic interests of US**

“Ukraine stands in the middle of the giant” --- there is no exaggeration to describe the important geostrategic status of Ukraine. Therefore, every action by Ukraine affects nerves of Russia and America. Although America didn’t go to the foreground during this natural gas dispute, it seems that she arranged and directed this game behind the scenes.

On January 9, 2009 when the natural gas dispute between Russia and Ukraine was on its summit, America and Georgia signed a security, economic and cultural cooperation agreement. America pointed out that, she also signed a strategic cooperation agreement with Ukraine on December 14, 2008, which deepened cooperation of these two countries in terms of their response to a crisis and their defense and security for promoting security and stabilization. The choice of America to sign a strategic agreement with Georgia at that that and to point out the similarity of this agreement to that between America and Ukraine was rather meaningful. On one hand, America inflicted pressure upon Russia. On the other hand, she supported and encouraged Ukraine, which might explain the extraordinary “bravery” of Ukraine during this natural gas dispute. On January 14, the Russian “Izvestia” reported in its article “America controlling Ukrainian pipelines” that, the natural gas transportation system of Ukraine will soon have its new master, who comes from the other side of the Great Ocean. This journal mastered content of the strategic partnership chapter signed by Ukraine Minister of Foreign Affairs Огрызко Владимир Станиславович and US Secretary of State Rice in December last year. The chapter mentioned that, Washington would help with modernization of natural gas pipeline in Ukraine. America had neither mined natural gas in Europe, nor transported natural gas to European transits, then why did she sign a transit agreement? The current US Secretary of State Hilary pointed out “deep thinking and plan far ahead” of America on this issue. She said, “My team and I will try to persuade our European partners to sign a political agreement which is aimed at guaranteeing to construct Nabucco and other potential natural gas pipelines, so as to help Europe with its natural gas supply. Success of the strategy to construct Nabucco and other replaceable natural gas pipelines requires unremitting cooperation at the political level, including cooperation with America. The new Obama government will have a positive effect on European energy supply situation. Dependency of Europe on Russian energy will result in a political dependency, and we will help Europe get out of this dependency. Our enlargement of trade and investment in energy across the Caspian Sea is our priority consideration.” Therefore, we can conclude intentions of US in its intervene in the natural gas dispute between Russia and Ukraine as follows: to support pro-western policy of Georgia and Ukraine, to weaken influences of Russia, to control energy across the Caspian Sea, and to further take control of EU.

Above all, during this “natural gas war” of Russia and Ukraine, the fact was that, Russia and Ukraine “had a contest” on

the surface, Russia and America “wrestled” behind, and EU “suffered” indirectly. Although the natural gas deal of Russia and Ukraine signed on January 19 finally got the natural gas dispute resolved, still there exist some pendent issues, and factors underlying “disagreement” of Russia and Ukraine for the second time still exist. Underlying superficial debt and price fight, geopolitics fight and game playing behind are the genuine origin that triggers the natural gas dispute.

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