Heli Simola and Laura Solanko

Gas once again a bone of contention between Russia and Ukraine
Heli Simola and Laura Solanko:
Gas once again a bone of contention between Russia and Ukraine

22.4.2014
ISSN 2342-205X (online)
Contents

Abstract .................................................................................................................................................. 3
Gazprom announced substantial gas price hikes for Ukraine ................................................................. 4
Ukraine afraid of supply cuts, but situation not easy for Gazprom either ............................................. 4
Most EU countries unlikely to face major difficulties from possible short-term disruptions in gas imports ........................................................................................................................................ 5
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

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

*calculated from monthly consumption in 2012


(n.a. = no data on stocks available)
BOFIT Policy Brief

http://www.bof.fi/bofit_en/tutkimus/tutkimusjulkaisut/policy_brief

2011
No 1 Laura Solanko: How to Liberalize a Thousand TWh Market? – Restructuring the Russian Power Sector
No 2 Maija Sirkjärvi: Suomen markkinaosuus Venäjällä on supistunut
No 3 Andrei Yakovlev and Olga Demidova: Access of firms to public procurement in Russia in the 2000s: before and after radical reform of regulation
No 4 Vesa Korhonen, Mia Hurtta, Maija Sirkjärvi, Iikka Salonen and Ilkka Korhonen: Venäjän integraatio maailmantalouteen
No 5 Sergey Vlasov: Russian fiscal framework: Past, present and future. Do we need a change?
No 6 Laura Solanko: Öljyntuottajamaiden elvytysvara on supistunut huomattavasti
No 7 Rikki Nuuttilainen and Laura Solanko: Metallien ja energian maailmankauppa kääntyi Kiinaan
No 8 Heli Simola: Suomi hyötyy Venäjän WTO-jäsenyydestä

2012
No 1 Risto Herrala, Juuso Kaaresvirta, Ilkka Korhonen and Jouko Rautava: Kiinan kasvava mahtii maailmantaloudessa. BOFIT Kiina-tietoisku 2011
No 2 Heli Simola: Russian import statistics in the mirror of world exports
No 3 Seija Lainela and Alexey Ponomarenko: Russian financial markets and monetary policy instruments
No 5 Risto Herrala, Juuso Kaaresvirta, Ilkka Korhonen, Mikael Mattlin, Jouko Rautava and Heli Simola: Valta vaihtuu, mikä muuttuu? BOFIT Kiina-tietoisku 2012

2013
No 1 K.C. Fung, Hsiang-Chih Hwang, Francis Ng and Jesús Seade: International trade and production networks: Comparisons of China and greater China versus India and South Asia
No 2 Heli Simola, Laura Solanko and Vesa Korhonen: Näkökulmia Venäjän energiasektoriin
No 3 Heli Simola, Laura Solanko and Vesa Korhonen: Perspectives on Russia’s energy sector
No 4 Hubert Fromlet: The Chinese Government Debt – What Do We Know and What Should Be Done?
No 5 Laura Solanko and Lauri Vilmi: Globalit energiamarkkinaan murroksessa
No 6 Laura Solanko and Lauri Vilmi: The transformation of global energy markets
No 7 Andrei Yakovlev: Is there a ‘new deal’ in state-business relations in Russia?
No 8 Ilkka Korhonen, Vesa Korhonen, Seija Lainela and Laura Solanko: Venäjän kasvu vaatii muutakin kuin energiata
No 9 Sergey Vlasov: Analysis of Russia’s fiscal sustainability under the new fiscal rules
No 10 Heli Simola: Turkin talous – saadaanko kasvu kestävälle pohjalle?
No 11 Juuso Kaaresvirta, Ilkka Korhonen, Jouko Rautava, Heli Simola and Laura Solanko: Kiina ja uudistusten aika. BOFIT Kiina-tietoisku 2013

2014
No 1 Jouko Rautava: Crimean crisis will cost Russia too
No 2 Jouko Rautava: Krimin kriisi on jo nyt tullut kalliiksi Venäjälle
No 3 Heli Simola: Tracing trade interdependency between EU and East Asia
No 4 Heli Simola and Laura Solanko: Kaasu jälleen kiistakapulana Venäjän ja Ukrainan välillä
No 5 Heli Simola and Laura Solanko: Gas once again a bone of contention between Russia and Ukraine