

## UKRAINE'S NEW GOVERNMENT OUTLINES ITS ENERGY POLICY

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Ukraine is approaching the heating season and agricultural autumn sowing season amid uncertainty over the price of gas, runaway prices on oil products and motor fuel, and with the state oil and gas company Naftohaz Ukrainy indebted to an extent that looks like insolvency. The new government's energy policy is being driven by these short-term emergencies. Prime Minister Viktor Yanukovich and Fuel and Energy Minister Yuriy Boyko outlined these difficulties at a series of working meetings and public appearances variously held in Kyiv, Donetsk, and the Crimea on August 12-14 (Interfax-Ukraine, UNIAN, August 12-15). The government hopes for some relief measures to be decided at Yanukovich's upcoming meeting in Sochi with Russian President Vladimir Putin. The new government regards Moscow's decision to maintain the price of gas for the second half of 2006 at \$95 per 1,000 cubic meters as a positive achievement. The January 2006 agreement, entered into by the previous Ukrainian authorities, would have allowed Gazprom and its offshoot RosUkrEnergo to raise that price after July 1. The government would see an even greater achievement if Russia would (according to Yanukovich) "reduce the price at least by one dollar" for the remainder of 2006, and it intends rather unrealistically to seek a price reduction for 2007. To restrain the price growth in the short-to-medium term, the government intends to propose Ukrainian investments in gas extraction projects in Russia (including an as yet unnamed gas field "close to Ukraine's territory," according to Yanukovich). It also offers to participate in the modernization and expansion of the Turkmenistan-Russia main pipeline's section on the territory of Uzbekistan, in return for preferential prices on certain volumes of gas for Ukraine. The government is also considering investing in gas and oil projects in the Persian Gulf region and North Africa. Deputy Prime Minister Andriy Kluyev is tasked to coordinate the work on all these options. Just which Ukrainian entities would be capable of providing investments on such a scale seems wholly unclear. The state budget faces a deficit of at least 10 billion hryvnya (at least \$2 billion) in 2006, as estimated at the August 14 cabinet of ministers session. The indebted Naftohaz Ukrainy also has lost any capacity for investment abroad or even at home -- a situation inherited by the new government from the previous authorities. By the new government's accounting, Naftohaz took out \$1.5 billion worth of loans in 2005. (Some of these loans were not used for the stated purpose of technological modernization, and some were taken in order to pay gas bills to Russia -- see *EDM*, June 22). Additionally, Naftohaz owes \$372 million to RosUkrEnergo in overdue debt for gas supplied in the first quarter of 2006. RosUkrEnergo has allowed Naftohaz to skip several deadlines on the tight payment schedule, but it threatens to sue in the Stockholm International Arbitration Court if Naftohaz does not pay that full amount by August 15. There is no official word yet on Ukraine's second-quarter gas bill, which seems also overdue. Moreover, Naftohaz is rapidly losing the income-generating capacity from internal market gas sales that might have balanced its budget. The new government seems reconciled to that situation -- again, one inherited from the previous authorities. Last year, the government and Naftohaz ceded most of the lucrative industrial sections of Ukraine's internal gas market to the joint venture UkrGazEnergo, an offshoot

of RosUkrEnergo, leaving Naftohaz with the deficit-ridden business of supplying gas to municipal utilities and the populace. According to Boyko at his April 14 news conference, Naftohaz must adjust to “the loss of the main component of its business: gas trading.” Indeed, Boyko proposes to complete that process by offering Russian gas suppliers still wider direct access to Ukraine’s internal market, turning retail networks of regional distribution companies over to Russian gas companies. In return for direct access to Ukrainian end consumers, the Russian side would offer Ukraine access to gas extraction projects in Russia. Boyko’s access-for-access proposal echoes Moscow’s argument to European countries, which is designed to lock them into long-term dependence on Gazprom. The new government is considering the possibility of importing relatively small gas volumes from Turkmenistan by direct contract -- that is, not through the middleman RosUkrEnergo, though inevitably through Gazprom’s pipelines. However, the Ukrainian government would not/could not pay a “significantly higher price for Turkmen gas” than the existing price. Turkmenistan sells gas to Russia -- including the gas earmarked for Ukraine through RosUkrEnergo -- at \$65 per 1,000 cubic meters, but has announced its intention to charge \$100 after October 1 (see *EDM*, June 23). Boyko was instrumental along with then-prime minister Yanukovich in bringing RosUkrEnergo into Ukraine in August 2004. Boyko was a member of RosUkrEnergo’s first coordinating committee at that time while also serving as chairman of Naftohaz Ukrainy. His first deputy at Naftohaz at that time, Volodymyr Sheludchenko, was appointed Naftohaz chairman on April 14 by the new government. Sheludchenko is a long-time former head of the Donetsk oblast’s gas distribution company (1991-2003) and a member of the Donetsk team that dominates the new government.

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