

Ukraine, Russia and the European Union: One Fact, One Concern and Many Uncertainties

The bitter political confrontation between **Russia** and **Ukraine** and its negative repercussions on Moscow's relations with Brussels and with other European capitals are causing serious concerns in view of the consequences of this crisis at the political, diplomatic, economic and energy levels. On this last aspect, the present is clear, the very short-term future is marked by great unease, and the medium and long term are replete with a number of major uncertainties.

Up to now, this crisis does not seem to have had any impact in energy terms. Oil and gas flows have not been disrupted and there has been no upsurge in prices. It is true that oil prices remain at a high level (**Brent** crude was fetching **\$109/barrel** for July contracts on **ICE Futures** in London on the morning of May 16, while **light sweet crude** was selling for **\$101-102/b** for June on the **CME Group** market in New York), but that was already the case before. It is nevertheless likely that what is happening in Ukraine is helping to keep crude oil prices at a high level, since the markets do not like political tensions in general, even though the implications are far greater in gas terms than oil terms.

The short-term future in this affair means June. Russia's political leaders and the Russian company **Gazprom** have indicated that, starting next month, Ukraine will only receive gas if it pays for it in advance. Gazprom estimates that **Naftogaz** owes it **\$3.5 billion** at the moment, and that is only for the gas it has consumed [a figure of **\$11 billion** is bandied about for the value of the gas that Ukraine has not imported but should have paid for under the **take-or-pay contract** between the two countries]. Russia says it is not going to cut off gas supplies to Ukraine and that it is up to Kiev to decide whether to pay for them or not, but in light of the country's financial situation, it is hard to see how Ukraine could pay for gas in advance when it has not been able to pay for it after delivery up to now [the price of the Russian gas supplied to Ukraine was increased by around 80% between the first and second quarters of this year].

In theory, it is not in the interests of either Russia, Ukraine, or the **European Union (EU)** to have to cope with a gas crisis akin to those that occurred in January 2006 and January 2009. Russia needs to export its gas, the EU needs to import Russian gas, and Kiev certainly does not want to cause any problems for the EU given its desire for a rapprochement with Europe. But if Ukraine were unable to import Russian gas to cover its domestic needs, the temptation to siphon off Russian gas passing across its territory on the way to Europe would be very strong. In that event, Russia might decide to cut off deliveries to Europe, something that has already happened twice in recent history. This is the main concern for the coming weeks.

That said, the most important worry is probably the **real or potential consequences of this crisis in the medium to long term**. As always, when it is a matter of political frictions, forecasts are impossible, but in any event one can identify some key questions for the future. For our part, we would raise seven:

- Will this crisis result in tougher **western sanctions** against Russia than those imposed to date, and if so, what will be their impact on the energy sector?
- What will be the knock-on effects of the current and future political situation on the **South Stream** gasline project being promoted by Gazprom and its European partners? This project is of capital importance for Russia, since the pipeline would have the capacity to transport **63 billion cubic meters/day** of natural gas. It has already run up against the problem of sluggish economic conditions in Europe and the continent's anemic gas demand and it has provoked the rage of the **European Commission**, which considers that the agreements concluded between Russia and a

number of European countries are not compatible with European competition legislation. Could South Stream survive the crisis between Russian and Ukraine? Gazprom maintains that everything is “business as usual”, but that is not really credible.

- Will the **United States**, which has become the world’s largest natural gas producer thanks to unconventional gas, come to Europe’s rescue in a few years’ time? The U.S. is now undertaking LNG projects and is expected to become a net gas exporter by 2018. In Washington, the Obama administration is under attack from critics in the Republican leadership, who accuse it of having taken too long to approve projects for exporting American gas to Europe or Asia. What could be Europe’s place in the United States’ LNG exports over the medium term?
- What room for maneuver could the present crisis create for gas exporters that already compete with Russia on the European market, or could do so in future? Among the current suppliers to Europe one thinks of **Algeria**, which has substantial surplus capacity, as well as **Qatar** and **Nigeria**. Among future exporters, the **Caspian Sea** region and the **Eastern Mediterranean** (see our report on pages 33-41), as well as **Mozambique** and **Tanzania** spring to mind.
- What could be the place of **Iran**, which is hungry to return to the world’s oil and gas markets and sees in the EU’s concerns a good opportunity to ask to be remembered to Europe’s political and economic leaders (see page 3)?
- In June the European Commission is due to unveil a list of proposals for reducing the EU’s dependence on Russian gas, and the main elements of this strategy are already known beforehand, since they are not new. Will the EU have the political will to go down that path, and if so, will it be for the long term? Is it prepared to pay the price for that?

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