The defeat of the orange was never a victory for Moscow. The compromise between the two main political factions keeps Ukraine in balance between Europe and Russia. Meanwhile the economic and energy scenes are suffering an abrupt downturn due to the increase in the price of gas. And it is precisely Russia that opposes the formation of a cartel, and hence Ukraine...

Kiev Prepares for a Cold Winter

UKRAINE 1

by Fernando Orlandi

A solution to the long political crisis in Ukraine following the Parliamentary elections of March 2006 was finally found at the beginning of August, with the surprise formation of an anti-orange government. On July 7 Oleksandr Morozov, leader of the Socialist Party, falling short of the promises made in the electoral campaign, broke his ties with those allies who were victims of the dispute (President Viktor Yushenko and former Prime Minister Yuliya Timoshenko), with a move to the opposing front and joining the party of Viktor Yanukovych and the Communist party.

This opened the way for the return of the person voted down by the orange revolution, Yanukovych, who at the beginning of August was appointed to the post of prime minister from the Verkhovna Rada, the Kiev Parliament.

However, the defeat of the Orange has not meant a victory for Moscow, as part of the compromise that restored the Yanukovych government to power is the country's hope for Western institutions (beginning with the so-called "universal declaration", a declaration of national unity and a commitment to maintain the efforts to integrate with the West) and because foreign policy remains under the president's control. For this reason Moscow did not display the triumph that some were expecting. As Sergei Markov, a political analyst connected to the Kremlin, observed, "Ukraine finds itself under the influence of external forces, especially the United States. Unfortunately, the influence of Russia is really minimal". The true loser of the Kiev political struggle was Yuliya Timoshenko.

Spoils system

Since recently taking power, Yanukovych has concerned himself with two things: to grant every position available to his followers, with a truly widespread spoils system; and to try to settle matters somewhat with Moscow.

The bulky rotation of people in key positions at every level, almost a cleansing process, has radically invested every structure of power and has been characterized as primarily regional, since the new nominees come almost exclusively from Donetsk, a region of mines and large metallurgy industries, where the vast majority of the population is Russian-speaking. Ironically, in an analysis of the

current changes in process, the Center studying socialistic trends in the Donbass (Donets Basin) has observed that "the thread running throughout is the idea that the most brilliant and more competent people of the entire country were born and grew up only in the Donets Basin".
In an interview with the "Rossiiskaya Gazeta", Yanukovych evidenced the necessity of not fighting with the neighbors, while Minister of Foreign Affairs Borys Tarasyuk declared himself in favor of restoring the old connections with Russia. Meanwhile the future holds the weighty issue of the energy bill due to Moscow. At the beginning of the year a mysterious five-year contract was signed for a gas supply (revealed in **east** issue n. 8) that should have guaranteed a competitive price to Ukraine. However, as was to be expected, all expectations were disappointed: the real beneficiaries turn out to be the shadowy personalities who control part of the intermediary corporation RusUkrEnergo, and the Russian monopolist Gazprom. Kiev, which had hoped for controlled gas prices, now finds itself undergoing a difficult rebound: with market prices, entire sections of the Ukrainian economy risk collapse, especially the chemical industry where gas represents up to around 70% of the costs. And on top of these figures are social costs.

The Sochi enigma

And so, just ten days after his induction into office, Yanukovych went to Sochi, where the Russian President held an informal summit of the EuroAsiatic Economic Community, an organization in which Ukraine is not a member.
The EuroAsia Economic Community was constituted in 2001 for the purpose of integrating the economies of some of the successor States of the USSR. The Kremlin has some ambitious objectives for the organization: it is seen as a tool to restore

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political and economic control not only of the countries of central Asia, but also the post-Soviet republics located in Europe. Russia, Belarus, Kazakhstan, Uzbekistan, Tajikistan and Kyrgyzstan are all part of the EuroAsia Economic Community. Thanks especially to the role of Kazakhstan, Russia has achieved some success in central Asia. Things seem to have gone otherwise in Europe where its sole ally, Belarus, under discredited President Alyaksandr Lukashenka, will certainly not be able to act as a mediator or serve as an attraction.

Yanukovych announced at Sochi that Russia and Ukraine had reached an agreement to hold gas prices unchanged until the end of 2006. He also added that he had agreed on future “price parameters” with Russian Prime Minister Mikhail Fradkov according to market principles. However he did not provide any indication of what these would be, leaving observers free to speculate on how much Ukraine would actually have to pay for gas in 2007, which had been the principal objective of the meeting.

There were enigmatic assertions added that gas prices would be connected to the “level of the economic relations” between the two countries. Fradkov was also decidedly vague: “Clearly we want to find a solution to all the difficult matters [between the two countries], but we must work from a market approach and from availability to explain the perspectives of our development and future co-operation in terms of gas and in other economic areas of our countries”. For some analysts this would seem to indicate greater involvement by Ukraine in the constitution of a single post-Soviet economic zone, a proposal strongly supported by Russia.

According to expert in energy matters Volodymyr Saprykin of the Razumkov Center in Kiev, the trip to Sochi can be characterized more as a ceremonial than a practical exercise, more form than substance. Furthermore, “from the Russians we have not felt any confirmation that the price of gas for Ukraine will remain unchanged until the end of this year”.

Although not rewarding Yanukovych in terms of the energy bill, Moscow is attempting to bring Ukraine back within its domain. Konstantin Zatulin, deputy of the Duma and director of the Institute of

_Viktor Yanukovich (in Parliament in this photo) has had to commit himself to maintaining the path of integration with the West in order to return to government
Facing page: Former Prime Minister Timoshenko with Socialist leader Moroz

Studies on the Community of Independent States, held that “despite the impression that the matter of energy dominated the meeting, the issue of integration of Ukraine must not be forgotten”.
Also discussed at the Sochi meeting, although behind closed doors, was the creation of a Euro-Asian hydro-electric consortium and the creation of a Customs union, all directed towards re-asserting the role and predominance of Moscow in the post-Soviet era. The Customs union would also represent a reply to Russia’s aborted entrance into the World Trade Organization, which President Putin desired as a result of the G8 summit of July in St. Petersburg. It could thus serve, as noted by Viktor Yasman, as the “prototype of a ruble zone”.

A gas cartel?

In Moscow circles another project, even more ambitious and fraught with implications for the EU, was added to this project. A question arises with ever greater frequency between the analysts and chancelleries of the West: is Russia, the world’s principal gas producer, preparing to create an OPEC (Organization of Petroleum Exporting Countries) for gas? This hypothesis has been discussed for years, but the recent memorandum signed by Russia and Algeria on August 4, with an invitation to co-ordinate the price of gas, may represent the first concrete step towards the creation of a similar cartel.
The idea of a cartel was first circulated by Putin in 2002. Despite the immediate support of the President of Kazakhstan Nursultan Nazarbaev, the proposal was shelved but not forgotten. It was brought out again last May, when Gazprom met various obstacles in its acquisition of energy distribution networks in Europe, while Russia declared itself opposed to activating the principles established in the Energy Charter signed by it, and showed its



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irritation at the energy policies of the EU. Valerii Yazev, president of the Energy Committee for the Duma (lower house of the Russian Parliament) and president of the Russian Gas Association, invited the formation of a cartel of gas producers at the conference on energy last May in Berlin. Yazev has accused EU bureaucrats of having "provoked the gas producers", who, "generally working alone lose in the negotiation process, dominated by the consumers who work in an organized fashion, like a cartel". Therefore Russia, "the main world producer", is forced to "constitute an alliance of suppliers that will be more effective and influential than OPEC".

There was also talk of a gas cartel at the conclusion of the June summit of the Shanghai Co-operation Organization, which includes China, Russia and four countries of central Asia. In the course of that summit Putin proposed the creation of an energy club, inside the organization. At the same summit Iranian President Mahmoud Ahmadinejad (the country has observer status) declared that co-ordination between the member countries could help "to anticipate the threats of the dominating powers and their aggressive interference in world trade". He also added that the energy co-operation between Russia and Iran "could become even more productive if we also had collaboration in terms of gas prices and gas pipelines".

Moscow has been determinedly courting Algeria, from which it obtained access to its deposits of gas and oil, and has begun a significant collaboration not only in prospecting but also in the marketing (Algerian Sonatrach will deliver to France the gas that Paris acquired in Russia). In March, Putin offered the cancellation of a debt of 4.7 billion dollars, while Algiers granted to Russia arms sales worth 7.5 billion dollars. And now Gazprom is beginning collaboration with the Libyan National Oil Corporation. The perspective of a gas OPEC could entice Algeria (number eight in gas resources), Iran and Qatar (second and third respectively for reserves). With this firm base, they would then be able to bring in Turkmenistan, Kazakhstan, Uzbekistan and Libya.

_Above, from left: Russian President Putin with Ukraine's Yanukovich, the chairman of the Russian energy committee Yazev and the President of Turkmenistan, Niyazov, at a meeting with Gazprom CEO Miller

The creation of such a cartel could have grave repercussions. Fixing prices would eliminate a portion of the competition and severely limit the ability of Europe (already subject to Russia and Algeria) to supply itself at more competitive prices. Consumers could risk becoming hostage to producers.

A "quasi-cartel"

A "quasi-cartel", although little known, already exists. This is the Gas Exporting Countries Forum, which met for the first time in Teheran in May 2001 with the membership of 15 producer countries. The member countries together represent 73% of world gas reserves, and 41% of its production. Algeria, Iran and Russia are among the countries constituting the Forum. Up to today the Gas Exporting Countries Forum has not taken any specific role, as it is void of structure, organizational site and personnel. After the signing of the Russian-Algerian Memorandum, one of the scenarios which could result is the transformation of the Forum into a true organization in its own right.

Paradoxically, the main obstacles to transforming the Forum into a gas OPEC come from Russia, where there is a rapidly growing internal demand for gas and where the monopolist Gazprom has little say in terms of liquidity. The lack of financial resources has prevented investments in major geological explorations and the development of new fields. If this situation remains then over the next 10-12 years Russia will be compelled to reduce exports in order to satisfy the national market. Gazprom, which has received extensive backing and every support from the Putin administration in terms of its foreign operations, is instead compelled by politics to sell the gas to the national market at 47 dollars per 1,000 cubic meters. Due to fear of possible repercussions, the Kremlin is in fact reluctant to increase the price. But keeping the price of gas artificially low in

_A protest in front of the Russian embassy in Kiev. Like other post-Soviet countries that depend on supplies of Russian gas, Ukraine is facing a very hard winter

Russia has prevented Gazprom from making profits in its own larger market.

A cartel would also be able to ask that gas be sold at a fixed price in Russia, a choice Putin would find difficult to venture today. A cartel would also be able to demand greater transparency in the Russian gas industry, something that the Kremlin definitely does not appreciate.

An unforeseen solution for the price of gas

To control the central Asian gas market, at the beginning of September Gazprom was forced to pay a price. During the Ashgabat conference and the meeting on September 5 between Aleksei Miller and the captain of the Turkmenistan Saparmurat Niyazov, Gazprom accepted an increase in the cost of Turkmen gas of about 40 percent. Until 2009, in fact, it will pay 100 dollars for 1,000 cubic meters.

Not reaching an agreement with Turkmenistan would have been a geo-political disaster, since Moscow's energy strategy for central Asia is based on controlling the gas from Ashgabat. In addition without this gas, Russia would not be in a position to honor its exports in Europe.

Success has also had a second price: this resolution marked the end of a period in which Gazprom, thanks to the monopoly of the export routes, forced its price on vendors.

Those suffering the immediate repercussions will be the countries of the post-Soviet era that are dependent on supplies from Russia, with Ukraine first. Analyst Natalya Milchakova cautioned "Nezavisimaya Gazeta", "... for the countries of the Community of Independent States to expect a mean increase of 20% by the end of this year and another 15% increase in 2007". According to Milchakova, this year's gas price to be paid by Kiev will be 114-115 dollars for 1,000 cubic meters. For other analysts this increase could be decidedly more, up to 160 dollars. This would put Kiev in a crisis as its 2007 budget was calculated projecting a highest price of 135 dollars.

The Ashgabat accord has opened a Pandora's box to increased gas prices. For Kiev the prospect is a decidedly ugly winter.