

---

## UKRAINE'S ELECTIONS HIGHLIGHT DEEP DIVIDES OVER NATURAL GAS

-

15.02.2019

---

EurActiv (15 February 2019)

The direction of Ukraines energy policies is of great interest to observers in Brussels and the European capitals, as a stable and prosperous Ukraine would increase overall European energy security, writes Robert Rapier.

*Robert Rapier is a chemical engineer and writer.*

In the nearly three decades since gaining its independence, Ukraine has been a country constrained by a closed, non-transparent energy sector. As the country seeks to improve ties with the West and ultimately integrate into the European Union, it has finally embarked upon a set of reforms aimed at creating a more transparent, market-oriented energy sector under incumbent president Petro Poroshenko.

The direction of Ukraines energy policies is of great interest to observers in Brussels and the European capitals, as a stable and prosperous Ukraine would increase overall European energy security. But those reforms have hardly gone uncontested. Instead, they have become a lightning rod as the country gears up for its presidential election in March, with Poroshenko pointing to endorsements from key outside stakeholders while his opponent and chief rival, former Prime Minister Yulia Tymoshenko, takes a populist approach that could potentially reverse some of the recent changes.

### **President Poroshenkos Reforms**

The International Monetary Fund (IMF) and EU have provided financial aid to Ukraine since the economic crisis brought on following Russias annexation of Crimea in 2014. In exchange, both organisations have stipulated the need to bring Ukraines energy policies in line with those of EU countries.

The governments refusal to raise energy prices – which had been kept artificially low since the Soviet era – had prompted the IMF to freeze aid in April 2017. Finally, last October, Ukraine announced that it had secured a new \$3.9 billion stand-by aid agreement with the IMF, but the government had to raise household gas prices by nearly 25% to meet the IMFs stipulations.

Although it was an unpopular move with Ukraines citizens, with natural gas prices rising drastically since 2013 for household and industrial users, the government warned that Ukraines financial situation was dire and that the country could become insolvent without continued financial

assistance. Poroshenko has credited higher prices in part for restoring profitability to the state-owned gas company Naftogaz, which produces about 80% of the countrys natural gas, and is the countrys biggest taxpayer.

Poroshenkos reforms also impacted the countrys gas transmission system. Naftogaz and Main Gas Pipelines of Ukraine have now signed a Memorandum of Understanding (MOU) to separate the production and transmission portions of Naftogaz. Ukraine plays a vitally important role in transporting natural gas from Russia to the EU via the company, a role which has led to a number of disputes between Naftogaz and Russian natural gas giant Gazprom, the worlds largest natural gas producer.

## **Tymoshenkos Campaign Proposals**

Energy price hikes are never popular, and current presidential challenger Yulia Tymoshenko has gone so far as to call them a genocide against the Ukrainian people. Under Ukraines deal with the IMF, the price of natural gas for Ukrainian households was raised to \$303 per 1,000 cubic meters from November 1. Tymoshenko maintains this price is far above the production cost for Naftogaz.

As a reference point, U.S. companies have profitably produced natural gas at an average spot price of about one-third this value over the past five years. That said, the cost to produce may not be the most valid metric for determining where gas prices should be set.

Tymoshenkos background in the natural gas industry makes her a formidable voice on issues surrounding Ukraines energy policies and its relationships with outside stakeholders. In her campaign for the presidency, she has proposed to create a real gas market and to cut the price of natural gas in half for the population. That, however, is contrary to the IMF and EUs requirements for future financial aid.

There is also another, more long-term downside: lower prices may also slow the development of Ukrainian shale gas resources that could greatly increase Ukraines energy security.

## **Energy Independence for Ukraine?**

Both candidates have pushed for Ukrainian energy independence, which is certainly not out of the realm of possibilities — especially in relation to natural gas. According to the 2018 BP Statistical Review of World Energy, Ukraine produced 19.4 billion cubic meters (BCM) of gas in 2017 and consumed 29.8 BCM. Ukraine has historically imported most of the shortfall from Russia, but given the disagreements with Gazprom, it now primarily bridges the gap by importing from Europe.

But Ukraine has 1.1 trillion cubic meters (TCM) of proved conventional natural gas reserves — enough to produce at 2017 rates for 54 years. More importantly, the U.S. Energy Information Administration estimates that Ukraine has 128 TCM of technically recoverable shale gas, the 4th highest of any country in Europe.

If these resource estimates prove to be correct, Ukraine has the potential to achieve the natural gas independence it has been seeking for years. In 2013, then-Prime Minister Mykola Azarov stated the countrys shale gas could be produced and sold to consumers at \$120 per 1,000

cubic meters, a price consistent with spot prices in the US.

However, the main reason why companies in the US have been willing to make the investments into shale gas production is the promise of rising prices. Higher natural gas prices, or at least the belief that prices will be higher, has spurred significant capital investments into US shale gas fields. Holding prices artificially low will likely discourage similar investment into Ukrainian shale gas.

### **Can the Market Correct Prices?**

Populist promises are easy to make, but it is hard to see how Tymoshenko can reconcile the requirements of outside stakeholders – whose financial support is key for Ukraines economic survival – with her campaign promises to reverse major reforms.

Beyond the impact on IMF and EU aid, such moves could also slow the development of the countrys shale gas resources. Over the longer term, allowing natural gas prices to rise should stimulate investments into Ukrainian shale gas production and allow the country to become self-sufficient in natural gas. That, in turn, may cause natural gas prices to fall on their own – as they did in the US after years of elevated prices led to a shale gas boom.

---

Kaynak/Source: