Ukraine’s gas transportation system as «valuable national asset»: the way to privatization

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Two significant events, that can influence not only further development of Ukraine’s gas transportation system (GTS) but also the whole national economy and change its geopolitical role in the future, have taken place in this sector recently. Firstly, the Naftogaz Ukrainy initialed the contract with the Russian Gazprom relating to volumes and terms of transit of Russian natural gas via the territory of Ukraine within 2003–2013. Secondly, at a meeting in St. Petersburg on June 9, 2002, Presidents of Ukraine and Russia Leonid Kuchma and Vladimir Putin signed the declaration on strategic cooperation in the gas field.

Under the contract with the Gazprom, the share of Ukraine in transit of Russian natural gas to Western European countries via its territory shall be not less than 110 billion cubic meters per annum. Document regulating the above issues is scheduled to be signed on June 21, 2002 at a meeting between Ukrainian and Russian Premiers Anatoliy Kinakh and Mikhail Kasyanov in Kharkiv. Experts believe that the above agreement will actually eliminate the threat of «disappearance» of Russian natural gas from Ukraine and allow the country to preserve the share of 110-112 billion cubic meters of transit natural gas. The agreement will also allay apprehensions that the Ukrainian gas transportation network will «stand idle», which can adversely affect the national economy and politics. Theoretically, the agreement will allow Ukraine to receive payment for transit of Russian natural gas in the amount of USD 1.4 billion. Although, according to Yuri Boiko, president of Ukraine’s major gas company Naftogaz Ukrainy, the issue of whether Ukraine will get money or in-kind payment for transit Russian gas has not yet been decided (the Kievskie Vedomosti, June 12, 2002).

Foundation of an international consortium represents another perspective direction of development of Ukraine’s gas sector. Under the above document, governments of Ukraine and Russia are ordered to work out and present for signing, within a short period, a joint agreement on strategic cooperation in the gas field. The document shall provide for foundation of an international consortium or joint venture dealing with management and development of the Ukrainian gas transportation system. A day later, German Chancellor Gerhard Schroder expressed the desire to join the agreement. News agencies inform that having discussed the initiative of the German Chancellor, who was positive about participation of German gas companies in the consortium, the parties made a
mutual conclusion that the above initiative could be viewed as a priority in the process of implementing decisions of Russian and Ukrainian Presidents. Implications of the meeting also served as a basis for signing of the declaration on cooperation in utilization of principal transit trunk gas pipelines located on the territory of Ukraine in order to ensure uninterrupted supplies of natural gas to European countries.

Experts believe that foundation of the international consortium will offer Ukraine an opportunity to attract about USD 2.5 billion for reconstruction of the national gas transportation network in the near future. Commenting on outcomes of the trilateral agreement, President of the Russian Federation Vladimir Putin predicted that within the next ten years, the amount of funds attracted for development of Ukrainian pipeline system may reach USD 15 billion. As a result of the meeting, Russian authorities announced about rejection of an excessively expensive and thereby ineffective idea of building the gas pipeline Byelorussia-Poland-Slovakia by-passing Ukraine.

At the same time, major processes in the frameworks of the Ukrainian gas transportation sector have just begun. Their development will depend on the content of the agreement and realization of its provisions.

Gas Transportation System

The Ukrainian gas transportation system is strategic national heritage. Due to its existence, Ukraine has the status of the gas transit country. So, gas transportation system is a key component of the national security. It is the case when beneficial geographical and strategic location of Ukraine and Soviet heritage, transformed into the Ukrainian GTS within the period of its independence, should potentially produce positive results in all aspects of the national economy in the geopolitical context.

As a matter of fact, the Ukrainian GTS started functioning right after disintegration of the USSR when natural redistribution of the branched gas transportation network of the former Soviet Union took place as a result of official border delimitation. Since then, the sphere of responsibility of the Ukrgazprom plant, referred to as «Joint Stock Company Ukrgazprom», has been established within the borders of Ukraine (see materials of the Institute for Reforms at http://part.org.ua). However, problems relating to distribution completed in mid 92 have been acute for long. In the opinion of experts from the Institute for Reforms, those problems were caused by the fact that frontiers of the territories previously serviced by different enterprises within the Ministry of Gas Industry of the USSR did not coincided with administrative borders of republics and regions. For instance, some linear production departments of principal trunk gas pipelines of the Kharkivtransgaz were localized in Bryansk, Orlov, Kursk and Belgorod regions of Russia and one of the linear production departments of the Donbastransgaz were sited in Rostov region. Such location was also typical for other segments of Ukraine’s gas transportation system.

According to the data of the Naftogaz Ukrainy, at present, Ukraine’s GTS ensures up to 93% of the transit of Russian natural gas to European countries. Within the period of
Ukraine’s independence, gas pipeline length increased by around 2.5 times. The overall length of the Ukrainian GST is 36.7 thousand kilometers, of which pipelines with a diameter of 1,000-1,400 mm constitute 35%. Along this network, 72 compressor stations with 112 compressor houses equipped with 710 gas pumping units and powerful system of 13 underground gas storage facilities ensure transportation of gas.

Gas pipeline capacity of the Ukrainian GTS is 290 billion cubic meters per annum at the point of inflow and equals 170 billion cubic meters per annum at the point of outflow (see the Naftogaz Ukrainy website). Comparative analysis of potential and actual gas pipeline capacity of the GTS leaves us with an assumption that Ukrainian gas pipelines are underutilized. In 2001, Ukraine reduced transit of natural gas supplied to Western European countries by 6.2% or up to 104.3 billion cubic meters as compared to 2000 (the Kievskie Vedomosti, June 12, 2002).

Cost of Ukraine’s GTS represents one of the major problems. According to expert assessment, it equals USD 22-30 billion. Data of the auditing company Price Waterhouse prove that minimal cost of the Ukrainian gas transportation network amounts to not less than USD 20 billion. Other experts believe that the GTS costs USD 30 billion and stress that its efficient maintenance can annually yield the national budget additional USD 2 billion. However, Yulia Tymoshenko, ex-Vice Prime Minister responsible for the fuel and energy complex and former leader of the corporation United Energy Systems of Ukraine (UESU), said that at the initial stage of formation of the Naftogaz Ukrainy in 1998, the network was appraised as worth UAH 750 million (the Zerkalo Nedeli, October 30, 1999). Following the presidential decree, the Naftogaz Ukrainy was founded instead of 240 state-owned enterprises within the oil and gas complex. The May 25, 1998 Cabinet resolution No. 747 «On Foundation of the National Joint Stock Company Naftogaz Ukrainy» established the single state-owned company for as a subject of organizational, administrative and economic influence on the Ukrainian energy market.

Underlying principles relating to the GTS were legally formulated. For example, Article 5 of the law of Ukraine No. 1524 «On Oil and Natural Gas» established principles of the public policy in the oil and natural gas field. One of them is to safeguard integrity and ensure efficient functioning of the Ukrainian gas transportation system and its uniform dispatch control.

Valuable National Asset

In general, the uniform gas transportation system confirms the above statement about Ukraine’s beneficial geopolitical location and, according to the definition of the Kuchma-Gohr Commission, is a valuable national asset. Ukraine is localized between natural gas extracting and consuming regions. Hence, not only Ukraine’s welfare but also the situation in the EU energy and industrial sectors depend upon developments in Ukraine and its ability to maintain and develop the gas transportation system, for natural gas is carried in transit via the territory of Ukraine to 19 European countries. Experts also accentuate the opportunity to exert economic influence on Russia thorough effective utilization of the existent gas transportation network. Meanwhile, the issue of efficient
and successful use of gas transportation network in the strategic context has always been on the agenda. The fact that gas pipelines are underutilized is not the matter of question. What matters is, first and foremost, Ukraine’s ability to derive political and financial benefits from its specific status of the gas transit country. Today, Ukraine’s receipts from gas trade are inadequate to its potential opportunities due to the country’s former and current gas debts. Yuri Boiko, president of the Naftogaz Ukrainy, asserts that the company profits just UAH 2.2 billion (prior to taxation) by transit of natural gas, whereas the Russian Gazprom pays USD 1.4 billion or about UAH 7.4 billion (the Day, 11 June, 2002). The remainder in the amount of nearly USD 5 billion is allocated for technological needs of the gas transportation system and repayment of the Naftogaz Ukrainy debts.

The issue of Ukrainian gas debt to Russia engenders certain economic problems relating not only to pricing policy, functioning of Ukraine’s industry, outstanding gas arrears and calculation of tariff rates and quotas but also to embargo on re-export of natural gas. At present, after transporting Russian natural gas via its territory, Ukraine actually sells all transit natural gas not to Western gas transportation companies, which seems more profitable, but to Russia. Such a situation was and is explained by Ukraine’s inability to reach agreement on respective issues with the Russian Gazprom, one of the large monopolist companies on the European gas markets. The Gazprom is utterly disinterested in Ukraine’s participation in competition for re-export. And Ukraine, being a Russia’s permanent gas debtor, could do nothing to change the situation.

Nevertheless, re-export opportunities do exist in Ukraine. Today, the country stores about 7 billion cubic meters of paid Turkmen natural gas in underground storage, of which 5 billion cubic meters belong to Turkmenistan (out of 30 billion cubic meters bought from that state). According to Yuri Boiko, re-export program has already been agreed with the Gazprom and certain progress can be traced (the Kievskie Vedomosti, June 12, 2002).

It should be mentioned that disputes over the amount of Ukraine’s natural gas debt and its approval in parliament provoked conflicts, which deteriorated relations between Ukraine and Russia. As long as the sum of Ukrainian debt for natural gas was not announced, its northern neighbor could influence Ukraine’s economy and politics. Only in 2000, Victor Yuschenko Cabinet officially recognized Ukrainian natural gas debt to Russia as worth USD 1.5 billion. In Ukraine, the above news evoked an ambiguous response. Alexandr Ryabchenko, head of Special Commission for Privatization at the parliament of Ukraine, said that too much about the issue of Ukraine’s gas debt was vague, as it was unclear what structures did not pay (the Day, August 3, 2000). The statement contains subtle hints about well-known gas transportation companies whose gas debts are honored by the others.

Anyway, debts must be paid. In late 1999, Russia and Ukraine signed an agreement, under which eleven Tu-160 and Tu-95MS bombers, ground equipment for aircraft and some 600 cruise missiles should altogether be turned over by Kyiv, and USD 285 million of Ukraine’s debt for gas should be written off.

Also, it should be mentioned that 1999–2000 were the years of the black PR campaign
around Ukrainian natural gas theft. In that period, the Russian media shouted that Ukraine tapped 15–18 million cubic meters of natural gas daily and 6.5 billion cubic meters annually. Similar official accusations against Ukraine were brought as well. For instance, Valeriy Otchertsov, president of the Itera Company, has reiterated that Ukraine tapped 10 billion cubic meters of natural gas.

Soon after, Ukrainian President Leonid Kuchma has also admitted that Ukraine tapped gas from the Gazprom pipeline to Western Europe. «The President of Ukraine has stressed twice that unsanctioned tapping of transit Russian gas dishonored our country. Only within five months of 2000, Ukraine tapped transit Russian gas worth nearly USD 800 million, which gave Russia additional opportunity to make pressure on Ukraine. And there is no explanation to that fact», the Secretary of Ukrainian National Security Council said (the Ukraina i Svit S’ohodni, June 17, 2000).

The above destroyed Ukraine’s repute. That is why it was decided to build a new gas pipeline by-passing Ukraine.

Except for the idea of building the bypass pipeline, Ukrainian gas theft and arrears evoked other senses directly related to potential privatization of the Ukrainian GTS by Russia. As a matter of fact, Ukrainian trunk oil and gas pipelines as well as the system of trunk pipeline transportation and underground oil and gas storage facilities are of national importance and therefore, under Article 2 of the February 19, 1997 law «On Introduction of Changes to the Law of Ukraine «Privatization of Property of State-Owned Enterprises», cannot be privatized. Notwithstanding the above prohibition, there were some attempts to privatize the Ukrainian GTS. Below we address some of them.

First public efforts to privatize gas transportation system of Ukraine were made as long ago as in 1994. That year, in an effort to get a tasty morsel of the natural gas market, the Russian Gazprom manipulated gas arrears. However, law-making initiatives of the Verkhovna Rada impeded those endeavors. Initiatives of local lobbyists to privatize Ukraine’s GTS represent a topic of individual discussion.

The United States of America, another strategic partner of Ukraine, made the next step on the way to privatization of the Ukrainian GTS. Kuchma-Gohr Commission signed a number of documents relating to implementation of initiatives to privatize the Ukrainian gas transportation system. In 1997, on the basis of the above initiatives, Shell International Gas Ltd tried to lobby its commercial interests in gas trade and proposed to purchase 49% of shares of the JSC Ukrgazprom for USD 1.5 billion. In the opinion of experts, the proposal demonstrated that the company appraised the Ukrainian GTS as worth only USD 3 billion.

The issue of Ukraine’s national debts was yet another step on the way to privatization of the gas transportation system. In 2000, at the negotiations on the gas issue, Yevhen Marchuk, Ukrainian National Security Council Secretary, reminded about the Russian proposal to write off natural gas debt for transfer of the part of Ukraine’s gas and oil transportation system in ownership of the Russian Federation. Privatization plan looked
as follows: 1/3 of the Ukrainian GTS should be owned by Ukraine, 1/3 – by European investors and 1/3 – by Russia. That time, the plan was not executed. Although, at Washington meeting in October 2001, emphasizing the need to attract large investments so that to increase competitiveness of the Ukrainian GTS, the present Premier of Ukraine stated that he would not oppose privatization of Ukraine’s GTS provided that the state would manage and supervise the system. According to the Prime Minister, options of privatization/concession of the Ukrainian gas transportation system options were considered, but whatever the case, Ukraine was going to retain controlling and managerial functions.

The afore-mentioned proposals seem to serve as the basis for respective declarations and agreements on foundation of the international consortium. However, many problems still remain unsettled.

As far as the agreement on foundation of the international consortium is concerned, its parties are proposed to establish it on the parity basis. Though, it is unclear how agreement stakeholders interpret the words «on the parity basis», since for Ukraine, the gas transportation system is a strategic object. In the viewpoint of Oleg Dubyna, First Vice Prime Minister of Ukraine, foundation of the consortium does not imply privatization of the GTS. «Consortium will mean management but not ownership», he said (the Day, June 11, 2002). Given the situation, the difference is minor. The Ruhrgas, the largest German grid gas company, will represent Germany in the consortium. This company holds stocks of the Russian Gazprom and thereby can directly purchase Russian natural gas. In 2000, the Ruhrgas AG was interested to build gas pipeline by-passing Ukraine. Company’s representatives participated in preparation of feasibility report for the Belarus–Poland–Slovakia gas pipeline. The issue of Ukraine’s gas arrears also remains unsettled, for there is a possibility that Ukraine’s natural gas debt to Russia can pose a serious problem to the national budget. Experts deem that such companies as Gazprom and Ruhrgas AG are interested to make minimal payments for transit of natural gas. Taking the above into account, Ukraine’s receipts from transit of natural gas will be much less than it expects. Hence, in order to change the situation and improve its position on the gas market, our country is looking for other gas transit companies willing to take part in the consortium, e.g. the Shell company.

Ratification of the agreement by Ukrainian parliament also raises doubts. Incidentally, the Communist Party of Ukraine and the Social Democratic Party of Ukraine (United) welcomed St.Petersburg’s initiatives of Ukraine, Russia and Germany, whereas Yulia Tymoshenko’s bloc voiced its negative attitude to the agreement. For instance, in the opinion of Olexandr Turchynov, leader of Yulia Tymoshenko’s bloc, gas transportation system is strategically important and must belong to the state, so any efforts of its privatization (through establishing a joint venture or consortium) will threaten national security of Ukraine. He said that the faction would oppose ratification of the agreement (the Vysoky Zamok, June 12, 2002). Leaders of the bloc Our Ukraine held conflicting opinions: Yuri Yekhanurov says that there is nothing to worry about, whereas Victor Pynzenyk emphasizes that privatization of the GTS is sheer nonsense and represents a legal method of profit privatization (the Vysoky Zamok, June 12, 2002). In his
viewpoint, the above will only increase dependence of Ukraine upon Russia.

Success of ratification of the agreement and realization of its provisions will mostly depend on Ukraine’s ability to advocate its national interests, exhibit rational behavior and gain powerful allies.

Reform of the gas sector of the national fuel and energy complex is inevitable in the context of Ukraine’s integration in the EU. One of the EU membership requirements is comprehensive reform of the above branch. Transparent privatization mechanisms (unfortunately, still absent in Ukraine) can serve as a solution to respective problems. What matters is how these economic transformations will be implemented, who will benefit from them and whether potential «valuable national asset» will finally retain its economic and geopolitical role...