

Why Gazprom Likes to Thumb Its Nose at Kiev

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Ukrainian President Viktor Yanukovich and President Vladimir Putin continue to humiliate political pundits.

Russia gained leverage by purchasing \$15 billion of Ukrainian debt and lowering gas prices for the country. Since Ukraine's government bonds are classified by rating agencies as "junk," Russia can now threaten Ukraine with sovereign default. .

Gazprom's unsuccessful proposals to nullify Ukraine's debt in return for pipeline control are likely because Kiev fundamentally disagrees with their debt from the contracted "take-or-pay" terms. Notably, Gazprom recently approved investment programs for alternative routes. Gazprom will expand sites in Kaliningrad, Germany and the Netherlands. This mitigates Ukraine's importance in satisfying Europe's higher winter gas demand.

The first project revolves around the Northern land-based pipeline to Europe via Belarus.

The increasingly favorable projections at the pipeline's source fields necessitate quickly doubling the pipeline's capacity. If necessary, the line can also be modified to feed into the Nord Stream pipeline. After Russia's successful energy diplomacy in the Balkan states, Gazprom increased their prioritization of the Southern Corridor project.

Prioritization of alternative routes indicates Gazprom's pessimism for the company's stable energy relations with Ukraine in the next five to 10 years. The federal government, not Gazprom, holds the economic leverage over Ukraine. This unstable political environment means that even the threat of sovereign default could have a significant impact on gas payments, destabilizing the European gas supply.

But tensions between the European Union and Russia will rise further over the EU's anti-monopoly charges against Gazprom. Gazprom has not yet applied for a monopoly exemption for the Southern project. Without an exemption, Russia may encourage more liquefied natural gas exports into Europe from Russia's independent companies.

Russia's European gas market will probably stabilize in the near to mid term as pipeline and storage options become increasingly diversified. But continued unstable supply and cost issues will likely to keep pushing more European countries to import cheaper Russian coal. It is highly likely that Ukraine will seek to continue balancing the competing energy influences of Russia and the EU until they start producing shale gas in the next five to 10 years.

At that point, Ukraine will be better suited to independently formulate its global energy agenda.

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