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Natural Gas Export Prices, Transit Fees and Security of Supply Russian-Ukrainian, Gazprom-Naftogaz Dispute

The disintegration of the former political and economic regime in central and eastern Europe and central Asia exposed many countries of the region to the global energy market from which, up to then, they had been partially shielded. At the core of the former system was the presence of vast energy resources, mainly in the Russian Federation and Central Asia. Because of these resources, and for other reasons as well, not much attention was paid to the real resource cost of energy; the internal transfer price mechanism systematically underpriced energy when compared to price levels prevailing in other parts of the world.

Significant price rises

With the market-based transition since 1989, countries in that part of the UNECE experienced significant rises in domestic energy prices, partly, though not wholly, due to higher energy import prices. Countries that heavily depended on imported energy were hardest hit since they experienced significantly higher energy import costs, resulting in terms-of-trade losses and a fall in real national income. The problem was compounded with many households not in a position to absorb significantly higher energy prices due to low real disposable income.

For various reasons, this transition and adjustment process has not yet fully run its course in a number of countries of Eastern Europe and Central Asia. The Russian-Ukrainian dispute over the price of Russian gas to the Ukraine is a case in point.

Global energy conditions

The desire of Russia and Gazprom to receive "market" or international prices is understandable but so is the concern of Ukraine and Naftogaz faced with higher import costs, a deterioration in the terms-

of-trade and consequently a fall in real national income. The direction of change, however, is obvious. The economic integration of Ukraine into the European and the world economy presupposes the need to adjust to global energy conditions.

Security of supply concerns

An additional complication is that Ukraine is a major transit country for Russian gas to Western Europe. Disputes over transit fees and/or import prices, which lead to disruptions of supplies, even if only very briefly, raise concern about security of supply in downstream countries.

International prices

Problems can still easily arise despite a negotiated five-year agreement. The average weighted price is double the previous price level but still only half the level of international prices. Furthermore, Turkmenistan and to a lesser extent Kazakhstan and Uzbekistan, which are smaller exporters of natural gas, are expected to demand much higher prices for the gas now going to the Ukraine and Russia (currently these exports are priced at about one-quarter of international prices).

Binding Europe together

The Russian-Ukrainian dispute has to be seen in a long-term perspective. For over 35 years, Russian gas has flowed to the heart and centre of Europe without major interruption. Likewise, gas has flowed from the North Sea southwards and from North Africa northwards into the heartland of Europe. The natural gas industry has truly been a model of what binds Europe together. The UNECE can be proud that it has contributed to this orderly expansion and integration through quiet diplomacy and its programme of work in energy. ↓



Question of the week



To George Kowalski,
Director of
the UNECE
Industrial
Restructuring,
Energy and
Enterprise
Development
Division

Last week was UNECE Gas Week?

Yes, we just completed an extensive week of meetings devoted to natural gas.

What issue was upper most in the minds of delegates?

This was security of energy and natural gas supplies. Indeed, energy security has re-emerged as a pressing issue for policymakers and the general public.

Why the concern?

This is primarily due to the tightening of energy markets, high crude oil and natural gas prices, tensions in the Middle East, the ever growing energy import dependence of many UNECE countries, energy infrastructure constraints and sabotage and terrorist attacks on energy installations.

Could you be more specific?

Well let's take a few examples. The recent extreme cold weather in the Russian Federation forced Gazprom to divert some gas supplies from export markets to meet increased domestic demand caused by the extreme weather. As a result, supplies to countries, such as Hungary and Italy that were also experiencing very cold weather, had to be cut back creating difficulties in those countries. But it should be noted that export volumes were still above minimum contracted ↓



Relevant ECE Energy Activities

There are at least three elements/activities in the programme of work in energy that directly address issues raised by the Russian-Ukrainian dispute.

There are currently three Task Forces under the UNECE Gas Centre addressing issues related to natural gas transportation and cross-border trade. The first deals with the implications of Gas Directives originating from the EU Commission; the second on ways to harmonize gas transportation rules and minimize barriers to cross-border trade; and the third on mapping out existing and prospective main gas supply/transit/transportation infrastructure, including liquefied natural gas. The participants consist of officials from the European gas industry. Twenty-four major European gas companies, including Gazprom and Naftogaz, support the Gas Centre financially and through their participation in its activities.



Roundtables on gas

The main UNECE intergovernmental body in the field of natural gas is the Working Party on Gas. It frequently holds Roundtables on various natural gas issues during its annual sessions. A Roundtable on cross-border trade and security of supply will be held at the next annual session in January 2007.

Energy security issues

The main intergovernmental body in the field of energy is the Committee on Sustainable Energy. It too examines periodically issues related to energy security and in 2003 established the Energy Security Forum, with participation from the private sector. Within the Energy Security Forum, there is a programme of work and a number of events planned for this year. While the main focus so far is on oil, security of natural gas supplies will be added where warranted.

In addition, there are other elements and activities of the programme of work in energy that indirectly address issues related to the dispute and, more broadly, energy security. ❖

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volumes. Another example is the natural gas pipeline to Georgia which was bombed by terrorists or criminal elements stopping all natural gas supplies to the country in the middle of winter, causing much hardship. Social tension and sabotage in Nigeria is disrupting Nigerian oil deliveries affecting world oil markets. And it was not too long ago, in 2003, that there were massive electric power blackouts in North America and Europe. Energy systems are indeed fragile in many respects.

Are high energy prices here to stay?

It is difficult to say. However, energy availability is a problem in some UNECE countries. It may not be a problem in absolute terms because almost all individuals in UNECE countries have access to commercial energy. But the problem is that energy costs represent a significant proportion of disposable income for households in the poorer and less developed UNECE countries. Likewise, the poor in developed countries are similarly affected. Higher energy prices can but increase this hardship and make it that much more unbearable. The UNECE has assessed this issue and drawn up guidelines for reforming national energy pricing. ❖

This week ...

30 January-3 February
Working Party on Brakes and Running Gear

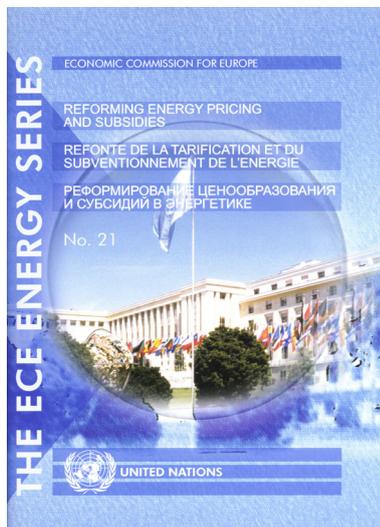
30 January-3 February
Working Party on Customs Questions affecting Transport

2 February
Administrative Committee for the TIR Convention 1975

30 January
Task Force on the Economic Benefits of Improving Mine Safety through Extraction and Use of Coal Mine Methane

31 January-1 February
Ad Hoc Group of Experts on Coal Mine Methane

2-3 February
Ad Hoc Group of Experts on Coal in Sustainable Development



Reforming Energy Pricing and Subsidies

Energy pricing reforms are essential for liberalising energy markets and promoting sustainable development in the UNECE region. Energy prices are crucial for balancing energy supply and demand. They have a strong influence on energy efficiency investments and are a powerful instrument for affecting the behaviour of consumers.

In response to the need for reforms, the Committee on Environmental Policy and the Committee on Sustainable Energy jointly prepared the 'Guidelines on Reforming Energy Pricing and Subsidies'* which was endorsed by the fifth

Ministerial Conference 'Environment for Europe' held in Kiev, Ukraine, during May 2003. The Guidelines cover the principles of tariff regulation, removing price distortions, encouraging efficient consumption, transparency of pricing. But they also include a section on support mechanisms for the poor, anticipating the social impact of rising energy prices referred to in the interview above. A review through workshops in 2006 - 2007 is foreseen to assess the progress made in adopting these guidelines and how energy prices have changed.

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* Guidelines on Reforming Energy Pricing and Subsidies, ECE Energy Series No. 21, United Nations Sales No. E/F/R.02.II.E.53, available in English, French and Russian (ECE/CEP/121 and ECE/ENERGY/54).

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