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East European Gas Analysis

December 20, 2005

Russian-Ukrainian Gas Conflict: Financial Effects of the Russian Side

Media reports and political statements misunderstand the economic part of Ukrainian gas transit problem. Gazprom does not simply sell gas to Ukraine as Turkmenistan does. Russian gas monopoly delivers gas as payment in kind for Ukrainian transit services. For years, the Ukrainian transit tariff was set at the rate, which allowed Ukraine to generate enough cash for an agreed volume of gas. The transit tariff matched the price of gas delivered as payment for transit services, which means that the value of payment gas was equal to the transit revenue of Ukraine.

After 2000, payment gas volume was agreed at 26 bcmy (billion cubic meters per year) and the price at $50/mcm (thousand cubic meters). Transit tariff was set at $1.0937/mcm per 100 km. At a briefing on June 7, 2005, Mr. A.Ryazanov, Deputy Chairman of Executive Board of Gazprom, said that the price and the tariff rate were very profitable for Gazprom and there was a good partnership and mutual understanding with Ukraine (http://www.gazprom.ru/articles/article16998.shtml).

By raising the price of payment gas, Gazprom increases its own transit expense in Ukraine. Ukraine, in turn, can raise its transit tariff to generate enough cash for buying the same volume of gas it gets now. Then Gazprom would have higher expenses, no profit and three times higher export duty.

On the positive side, Ukrainian transit tariff is linked to the tariff Gazprom charges for the transit of Turkmen gas. A raise of Ukrainian tariff also increases the transit revenue of Gazprom.

Table 1 shows our estimations of effects of the raise of gas price for Ukraine on the financial results of Gazprom. For the sake of comparison, we use the transportation work and transit volumes of 2004.

Table 1: Gazprom's Financial Results of the Raise of Ukrainian Gas Price

	Unit	**$50/mcm**	**$120/mcm**	**$160/mcm**
Gazprom sales revenue:				
Gas volume	bcm	26	26	26
Value of gas	$ million	1300	3120	4160
Cash payment for transit	$ million	250	3120	4160
Cost of transit service	$ million	1550	3120	4160
Transportation work	thous. bcm * km	142	142	142
Transit tariff	$/mcm/100km	**1.09**	**2.20**	**2.94**
Export duty of Gazprom	$ million	390	936	1248
Difference from 2005	$ million	-	-546	-858
Gazprom transit revenue:				
Transit volume from Turkmenistan	bcm	34	34	34
Transit tariff	$/mcm/100km	**1.09**	**2.20**	**2.94**
Gross transit revenue	$ million	312	629	838
Difference from 2005	$ million	-	316	526
Combined result of Gazprom:	**$ million**	**-**	**-230**	**-332**

Compared with the current rate of $50/mcm, a raise of price to $120/mcm adds $316 million in transit revenues, but takes $546 million in additional exports duties. The combined result of price increase from $50/mcm to $120/mcm is a loss of $230 million. If the price is raised to $160/mcm, then the loss increases to $332 million.

Please note that the current price of $50/mcm is below the estimated cost of Russian gas delivered to the Ukrainian border, so Gazprom is breaking the Russian tax code for over a year.

Russian side is likely to have the following effects of the raise of gas price for Ukraine. The government gains as tax collector, but loses as the main shareholder of Gazprom. All minority shareholders of Gazprom just lose.

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