Special Bulletin

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# Tense Ukraine Situation and Its Impact on Energy Market (2)

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The Ukraine situation has remained tense. After Russian and pro-Russia forces took control of the Crimea peninsula, the focus of attention at present is a March 16 referendum in Ukraine's Crimea region over whether the region should join Russia.

Given that pro-Russian citizens account for some 60% of residents in the region and that pro-Russian forces have taken control of the region, the referendum is likely to find that a majority of voters support Crimea's accession to Russia. The Group of Seven Western industrial countries as well as the interim Ukrainian government have strongly called for conserving the national, territorial and sovereign integrity of Ukraine and claim that the planned referendum would have no legal validity. On March 12, G7 and European Union leaders in their statements rejected the referendum and threatened to "take further action" or toughen economic sanctions on Russia if Russia annexes Crimea. On the same day, U.S. President Barack Obama met with Ukrainian Prime Minister Arseniy Yatsenyuk at the White House, vowing to "completely reject" the referendum and warning that Russia will have to pay a price.

But Russia has insisted on the lawfulness of the referendum and refused to recognize the interim Ukrainian government. Tensions are growing over Crimea, Ukraine and Russia ahead of the March 16 referendum. Western countries including the United States have growingly viewed the Russian action as a challenge to the post-Cold War order in Europe and as forcing a change to the status quo. Their views about Russia are growing severer. Based on such views of Russia, they have begun to acknowledge that they should reconsider international strategies.

As international tensions grow over Russia, we see attention-attracting developments related to energy problems. I would like to focus on two of them here.

First, there is concern about possible interruptions to Russia's gas supply to Ukraine and Europe. In January 2009, Russia suspended gas supply to Europe amid its gas conflict with Ukraine. As Russia-Ukraine tensions have grown again, Russia's Gazprom has pointed out that Ukrainian gas payments in arrears have reached $1.9 billion. Gazprom thus threatened to suspend gas supply to Ukraine unless the payments are made. Ukraine is an important transit country for energy supply from Russia to Europe. As of 2012, 50 percent of Russian gas supply to the European market was going through Ukraine. If Russia suspends gas supply to Ukraine as seen in 2009, supply to the European market may be reduced eventually. Europe depends on Russia for 30% of its gas supply. Particularly, Central and East European countries and Italy depend heavily on Russian gas supply.

But the situation at present is different from that in 2009. Nord Stream and other routes and supply channels bypassing Ukraine have been developed to reduce Europe's dependence on Russian gas via Ukraine from 80% to 50%. The gas supply-demand balance in Europe has eased due to an economic slump and a warmer winter, leaving gas inventories at high levels. Therefore, interruptions to Russian gas supply to Ukraine are dominantly expected to have a limited impact on the supply-demand balance as compared to the case in 2009. If Russian gas supply is interrupted again, however, it will be taken as a grave development regarding energy security, greatly affecting Russia's credibility as a gas supplier. The impact will go beyond Europe, bringing about unignorable implications for the Asian market where Russia is seeking to expand its energy supply.

Second, a new U.S. response to the Russian gas supply interruption problem is attracting attention. An emerging U.S. argument calls for the United States to provide the European market with liquefied natural gas in a strategic response to interruptions to Russian gas supply. The basic idea behind the argument is that if Russia uses its natural gas and oil supply to Europe as leverage in negotiating against Western countries, the United States should take advantage of its growing gas (LNG) and oil output under the shale revolution to counter such Russian action. But it would not be the U.S. government exporting LNG to Europe but rather private sector companies. Furthermore, U.S. LNG exports to Europe, which would not come in the near future, may not be able to counter interruptions to Russian gas supply that could come immediately. Even if LNG exports to Europe were to be implemented, the United States may have to use LNG exports bound for other markets, prompting the other markets to look for substitute LNG supply sources. The global supply-demand balance may remain unchanged.

Irrespective of the feasibility or actual impact of U.S. LNG exports to Europe, the issue is that the argument for the strategic use of oil and gas exports has emerged in response to the Russian/Ukraine problem. Whatever the fate of the argument would be, it represents a new development brought about by the Ukraine crisis in regard to the shale revolution and energy geopolitics. The United States may seek to strategically use its growing gas and oil supply under the shale revolution to check Russia. We must pay attention to such strategic tool that may be used not only against Russia but also against others according to whether its use meets U.S. national interests.

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