“Gasmail,”
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It’s January, the season of long nights, cold days – and the suspension of Russian gas deliveries. In a moment of high drama, Russian TV on January 5 showed Prime Minister Vladimir Putin telling Gazprom CEO Aleksei Miller, “Yes, cut it today,” when Miller reported that Ukraine was siphoning off gas meant for Europe.

Journalists covering the story like to put it into a historical context – which usually means going back to the three-day shutdown that occurred in January 2006. But it’s worth remembering that the problem is much older that that. The temporary turnoffs of Russian gas to Ukraine and Belarus go back at least to January 1996 – when Boris Yeltsin was still the West’s best hope, and long before the macho Vladimir Putin took the helm.

What is different about this crisis than the one in 2006 – or 1996? And what has stayed the same?

One difference is that this is the first time that there has been a serious interruption of supplies, causing radical cutbacks in consumption. Bulgaria, Croatia and Serbia have been especially hard hit. Previous interruptions were nominal, lasting no more than a couple of days, and did not cause actual stoppages.

A second difference is the desperate economic situation. Moscow is coming off a ten-year growth spurt, and the Kremlin is very worried about the impact of the global crisis on government revenues and ordinary living standards. You might think this would make Moscow less willing to risk a disruption of gas exports – but on the contrary it seems to have made them ready to double down for a full confrontation. Ukraine was always in poor economic shape – but it too saw a deterioration this past year. Ukraine ran a $12 billion trade deficit in 2008. A $16.5 billion loan from the IMF will see it through the winter, but an estimated $41 billion in debts are falling due next year.

Third, this time around Moscow is trying a little bit harder to win the propaganda war. Gazprom’s top executives, Alexei Miller and Alexander Medvedev, have been dispatched to European capitals. And they have hired the public relations firm Omnico, and its Brussels subsidiary, Gplus Europe, to get out the message. Gazprom even created a website to explain their position (www.gazpromukrainefacts.com) – though it looks like it was put together by the intern over the winter break. (This in a company which made $70 billion profit last year.)

Otherwise, just about all the elements of the annual Russo-Ukrainian gas drama are in place. By now, all the actors in this Kabuki-style performance know their lines, and the correct postures to strike.

The first unchanging factor is the basic geo-economic reality. Four gas export pipelines cross Ukraine carrying 300 million cubic meters a day, of which around 65 million is tapped for Ukraine’s domestic needs. If Ukraine takes out gas in the absence of a contract, there is nothing Russia can do short of shutting down the flow entirely (which is what they did on Monday January 5th). That step obviously harms Gazprom just as much as it hurts Ukraine. In fact it hurts Gazprom more than it hurts Ukraine. Ukraine can afford to play hardball because its vast storage capacity (inherited from the Soviet times) is sufficient to cover two-three months of domestic supply – unlike hapless Bulgaria.

There is nothing in economic theory which will tell you how to distribute the rents from a fixed asset like a pipeline between the supplier and transit country. In such a situation there is not such a thing as a fair price, nor a market competitive price. It's just a question of political will and bargaining power – at least until such time as the construction of new pipelines such as North Stream gives Russia the option of avoiding Ukraine entirely.

The second constant is the character of the two protagonists. On one side we have the Kremlin, eager to flex its geopolitical muscles behind a façade of reasonableness. And in Kyiv we have the usual political stalemate, bitter personal rivalries, polarized political parties and a constitutional deadlock between president and parliament. Moscow argues that the whole crisis has been artificially created by Ukrainian politicians, keen to shake more aid money from the West and to embarrass each other in the run-up to the next presidential elections. The Kremlin's critics suggest that they are interested in payback for Ukraine's support of Georgia in the August war. Or perhaps Moscow wants to crank up the pressure so as to clear away the objections to the construction of the North Stream pipeline on the Baltic seabed – that will reduce dependency on the Ukrainian route.

A third recurrent factor is the murkiness of the whole situation. Details about prices offered and actually paid are shrouded in mystery. Both sides seem to prefer it that way, funneling the transactions through shadowy third parties, notably the joint venture RosUkrEnergo. Most analysts see RosUkrEnergo as a vehicle through which Russia can channel some of the profits from the gas trade to select oligarchs inside Ukraine – who will presumably return the favor in some manner. Ukrainian politicians go along with this because they or their associates are being cut in on the deal.

It's hard to tell just how far apart the two sides really are. Ukraine apparently managed, at the eleventh hour, to pay off its $1.6 billion debt for 2008 – but now Gazprom is claiming $600 million in late fees. Kyiv's defenders point out that the price of $250 per 1,000 cubic meters that Gazprom at one point offered is not that different from the $235 that Ukraine is currently suggesting. And anyway, the fall in world oil prices will translate through to lower European has prices in 6-9 months. From a peak of $530 late last year, they are expected to fall to around $250. The price Ukraine has paid has steadily risen, from $50 in 2005, $95 in 2006, $135 in 2007, to $179.50 in 2008. Meanwhile, Belarus paid only $129 in 2008, enjoying a "dictator's discount." So what is the problem?

Another possible difference from previous years may be the willingness of both sides to internationalize the dispute. European Union Commission President Jose Manuel Barroso is working on sending monitors to check the flow of gas through the pipeline. That could at least clear up whether Gazprom or Ukraine is responsible for interrupting the European supplies.

The long-term solution is clear enough – multi-year contracts with the gas price tied to the global oil price. The Yamal pipeline across Belarus and Poland could be a model. Although there was a serious disagreement with Belarus in 2006, the Polish section of the pipeline has operated without interruption since it was built in 1994. A 2006 dispute over a proposed 6 cents per 100 km increase in transit fees was taken to the International Commercial Arbitration Court, which awarded the Polish partner $20 million. One difference, however, is that in the Polish case the pipeline is owned by a joint venture between Gazprom and Poland's PGNiG, who agreed – before the pipeline was built – to run it on a cost-plus basis. Ukraine has consistently refused to give up ownership in the pipeline network on its territory, even when Gazprom suggested a joint venture with a German partner.

The whole situation is reminiscent of the fable about the frog and the scorpion. The scorpion asks the frog to carry him across the river. The frog agrees, after the scorpion promises not to harm him. But mid-stream, he stings the frog, and they both drown. The scorpion explains “I’m a scorpion. It’s in my nature to sting.”