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External Financing of Restructuring in the Energy Sector: the experience of
Gaztranzit company in Ukraine

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It is evident that Ukraine needs new large-scale inflow of investment for the restructuring of its economy. On every count - supplementary investment finance, technological and management upgrading, the imperatives of restructuring a remnant of the old Soviet heavy industrial complex cries out for FDI. Quite apart from residual ideologically-derived suspicions of foreign business, however, appropriate conditions for FDI have not been created in Ukraine since the beginning of the 1990s. If we checklist the main factors that go to create a favourable environment for FDI that were determined by the World Bank:

- Trust in the government of the host country
- Macroeconomic stability
- Reliable information about the domestic economic situation
- Stable system of taxes and regulatory framework
- Liberalisation of foreign trade
- Easing of bureaucracy
- Developed business infrastructure
- No serious problem of criminality,

it is clear that Ukraine does not fully meet any of these conditions. But in recent years, the situation has changed, and in conditions of economic growth FDI inflow has accelerated. So, in 2002 total amount of FDI jumped by more than 800 million USD to 5.34 bn USD. It is much less than in neighbouring Hungary or Poland but, anyway, general dynamics is positive.

Investment in the East European countries has promised high returns, especially at the initial moment of euphoria expectations. However, the risks are clearly bigger and more complex than in the West, involving relations with local authorities, levels of qualification of the labour force, provision of infrastructure and so on. After a number of years of relative failure, foreign companies have now changed their strategy, in game-theoretic terms, from a one-stage game to a multi-stage game. First, they seek to establish an office to collect information or to start trading activity to recoup sunk costs. Second, they usually try to find a local partner well acquainted with local conditions and to start a comparatively modest commercial project.

Substantial part of FDI are going through joint ventures, as foreign companies have no enough knowledge about the local markets and an intention to minimize risks by sharing them with local partners. There are still a number of barriers on the way of effective co-operation between western and Ukrainian companies and attracting the FDI or credits to the Ukrainian economy.

In this context, the history of ZAO 'Gastransit' could be of interest, as the company has become one of the biggest recipients of foreign credits in Ukraine in recent years.

In January 1994 "The Agreement between the Government of the Russian Federation and the Government of Ukraine on Russian Natural Gas Export to Ukraine and its Transit Via the Territory of Ukraine to the European Countries" was concluded in Moscow. In November 1997, for the execution of this Agreement, as well as for the execution of the Agreement "About the Long-term Cooperation for Increasing and Reconstruction of Transit Capacities on the Territory of Ukraine for Russian Natural Gas Transport" signed between the OJSC Gazprom and JSC Ukgasprom on 3 June 1994 in Kyiv, CJSC Gastransit with foreign investments was established. The Shareholders of CJSC Gastransit are:

NJSC Naftogaz of Ukraine (Ukraine) - 37% of shares;
OJSC Gazprom (Russia) - 37% of shares;
JSC Turusgas (Turkey) - 18% of shares;
JSC Transbalkan (Turkey) - 8% of shares.

The main purpose CJSC Gastransit was established for was the extension of the throughput capacity of Ukrainian gas transportation system in order to increase Russian gas transit to Turkey and the countries of Balkan region by means of new capacities construction.

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According to the Charter, the main activities of CJSC Gastransit are:
the arrangement of financing of construction and operation of newly established facilities of gas transportation system of Ukraine with the purpose to increase the export of the Russian natural gas;
designing and construction of the gas pipelines, compressor stations, and other technological facilities;
extension of existing gas transportation systems;
operation of the newly constructed capacities at the territory of Ukraine.

Taking into account the already signed contractual obligations on the delivery of Russian gas, CJSC Gastransit in cooperation with OJSC Gazprom and NJSC Naftogaz of Ukraine worked out the long-term conception for the extension of industrial capacity which would be sufficient for the transportation of the additional gas amounts necessary to satisfy the increasing demand in natural gas in the countries of Balkan region and Turkey. The Feasibility Report on the project of throughput capacity extension of this gas pipeline was worked out.

To optimize the usage of finance resources, the Project of CJSC Gastransit is divided into two phases:

Phase I – construction of the compressor station Tarutino (Odessa oblast) on the stream of the existing gas pipeline Ananjev-Tiraspol-Izmail that will allow to increase the throughput capacity on 3.9 bcm/annum,

Phase II – step-by-step construction of the new main gas pipeline Ananjev-Izmail with diameter of 1220 mm of entire length 389 km that will allow to increase the throughput capacity of the gas pipeline on more 7.6 bcm/annum and construction of underwater crossing though the river of Danube of entire length 6.2 km.

The aggregate throughput capacity is expected to increase up to 27.6 bcm/annum in this technological corridor after the completion of the whole Project.

In fact, creation of Gastransit can be described as response to, first, non-adequate regulations in privatization sphere in Ukraine and, the second, to the impossibility of NJSC Naftogaz to be an equal partner for foreign companies. The first reason is related to the ban on privatization and especially to transfer of pipelines to foreign companies. This ban has been established by the Ukrainian Parliament in early 1990s to prevent the transfer of key national assets to foreign firms. The second reason is related to heavy debts of the NJSC Naftogaz. No foreign bank could provide the company with new credits. So, Gastransit has become an effective answer, aimed to overcome existed difficulties.

First Phase of the Project – construction of the Compressor Station Tarutino

The implementation of the Phase I of the Project - construction of the compressor station Tarutino - was commenced in the late 1999. In May 2001 the industrial operation of the station was begun, and in September the State Acceptance Commission accepted the whole complex of CS Tarutino consisting of the compressor station, external power supply system of CS, living complex for the servicing personnel of CS and the cleaning facilities with the main sewage collector.

It is one of the modern compressor stations in Ukraine, which have been commissioned recently.

The commissioning of the compressor station Tarutino complex allowed increasing the throughput capacity of Ananjev-Tiraspol-Izmail gas pipeline up to 20 bcm/annum.

Aggregate cost of the Phase I of the Project amounts to USD 78.000.000, consisting of:
26.000.000 – contributions of the Shareholders of CJSC Gastransit paid both in cash and in in-kind forms,
52.000.000 – loan recourses.

The Shareholders of the company obtained the loan of the European Bank for Reconstruction and Development in the amount of USD 40.000.000 for the construction of the gas compressor station. Black

Sea Trade & Development Bank (“BSTDB”) acted as a Joint Lender of the project in the amount of USD 12.000.000 (project of CJSC Gastransit is the first project financed by BSTDB). The loan was granted for a period of 9 years without state guarantees. The Contracts on gas supply to Turkey and the property of CJSC Gastransit were taken as the security for the loan.

CJSC Gastransit has already commenced the repayment of the principal debt and the interests. Proceeds obtained by CJSC Gastransit for the gas compression services provided to OJSC Gazprom are the source for the loan repayment.

The operation of the CS Tarutino is performed in accordance with the Compression Contract between CJSC Gastransit and OJSC Gazprom. Only for the year of 2002 the volume of the compressed gas amounted to 8.8 bcm.

Second Phase of the Project – Construction of the Second Line of the Main Gas Pipeline Ananjev-Izmail

Taking into account the considerable cost of the construction of the main gas pipeline, and because the major part of new gas pipeline route runs parallel to the existing pipeline, CJSC Gastransit anticipated step-by-step construction of the gas pipeline by means of construction of loopings – parallel passage sectors – at the existing gas pipeline. Step-by-step construction of the second line and the subsequent operation of loopings in one operating practice with the existing gas pipeline will allow gradual increasing of gas transit amounts in the direction of the countries of Balkan region and Turkey.

The Phase II includes the construction of the DN1200 40 km-long looping downstream CS Ananjev and 30 km-long one upstream CS Orlovka, as well as the construction of the new line of the underwater crossing through the river of Danube. In this case, the increase in the throughput capacity of Ananjev-Tiraspol-Izmail gas pipeline will make up 1.6 bcm/annum.

As in the case of the compressor station construction, the financing of the Phase II of the Project is being performed using the funds of the shareholders and the loan facilities. The funds obtained by CJSC Gastransit as the payment for services of gas transportation through newly constructed sections of the gas pipeline are the source of the loan repayment.

The aggregate cost of the project makes up USD 118.000.000. Syndicate of banks arranged by EBRD provides USD 97.000.000 of this sum. Black Sea Trade & Development Bank (Greece), Bayerische Hypo- und Vereinsbank AG (Germany) and Agricultural Bank of Greece are the members of this syndicate. The Board of Directors of EBRD approved the loan granting for the I stage of the Phase II of Project of CJSC Gastransit, and the Loan Agreement was signed in the late 2001.

The new loan is granted for a period of time until the year of 2009, although it could be prolonged until the year of 2013 and, as the previous one, does not provide for the state guarantees.

The design of construction of the Phase II is performed by OJSC Ukgasproject institute at high technical level with using modern design and engineering requirements and production possibilities.

Turkish construction company JSC Transbalkan acts as the General Contractor of the construction.

Mainly Ukrainian construction companies and manufactures of materials and equipment are involved in construction of the second line of the main gas pipeline Ananjev-Izmail. Along with that, some foreign companies and firms – OJSC Pidvodtruboprovodbud (Russia), OJSC Zangas (Russia), “Raychem” (Germany) and “Canusa” (Canada) – are engaged in performing separate special works and supply of the equipment.

In August 2002 the construction of loopings was began as well as the works were performed at the fire “in-cuts” to the existing gas pipeline Ananjev-Tiraspol-Izmail at 7 connection pipes. This technologically unique type of work connected with the risk was performed at the high professional level within five days.

Active works are performed at the construction of the linear part of the gas pipeline and the underwater crossing through the river of Danube.

A particular feature of this construction due to the densely populated area of the pipe line route is a number of crossings through the highways, underground communications, communication cables and overhead high voltage transmission lines, as well as complicated relief – gullies, ravines, numerous rivers and floodlands.

Perspectives of development of CJSC Gastransit

In March 2003, institute Ukgasproekt worked out the Technical and economical offers (TEO), ordered by CJSC Gastransit and AC Ukrtransgaz, for further development of gas transportation capacity of gas pipelines.3303 0 0awz4.2764-5.870.3(i.3(l.)T.4()5 TD0 Tc82Tc01322 Tw(A)5)-568(p)6.ap(ov3 0b7.ni)-9.C(k7.1