EU's external energy policy: The Russian Case

cernoch@mail.muni.cz

Russia is ´a great power´

For Russia and its citizens, a great power status is absolutely critical.

The essentials of a great power:

- Significant military and economic potential.
- Ability and willingness to resort to unilateral (typically military) action.
- Operates over large (global) area.
- Has the will to act like a great power.

(Russia background comments based on M. Romancov´s work)

How does Russia view itself?

- Russia is large (It always was).
- Russia is victorious.
- Russia is exceptional.
- Russia needs to be respected and shown gratitude (WWII).

Molotov – Ribbentrop Pact (1939)

- Non-aggression pact between Germany and Soviet Union – guarantee of peace + neither goverment would ally itself to or aid an enemy of the other.
- Secret protocol – defining of spheres of influence across Poland, Lithuania, Latvia, Estonia, Finland.
- SSSR invading Poland, Finland, Estonia, Latvia, Lithuania, Romania…

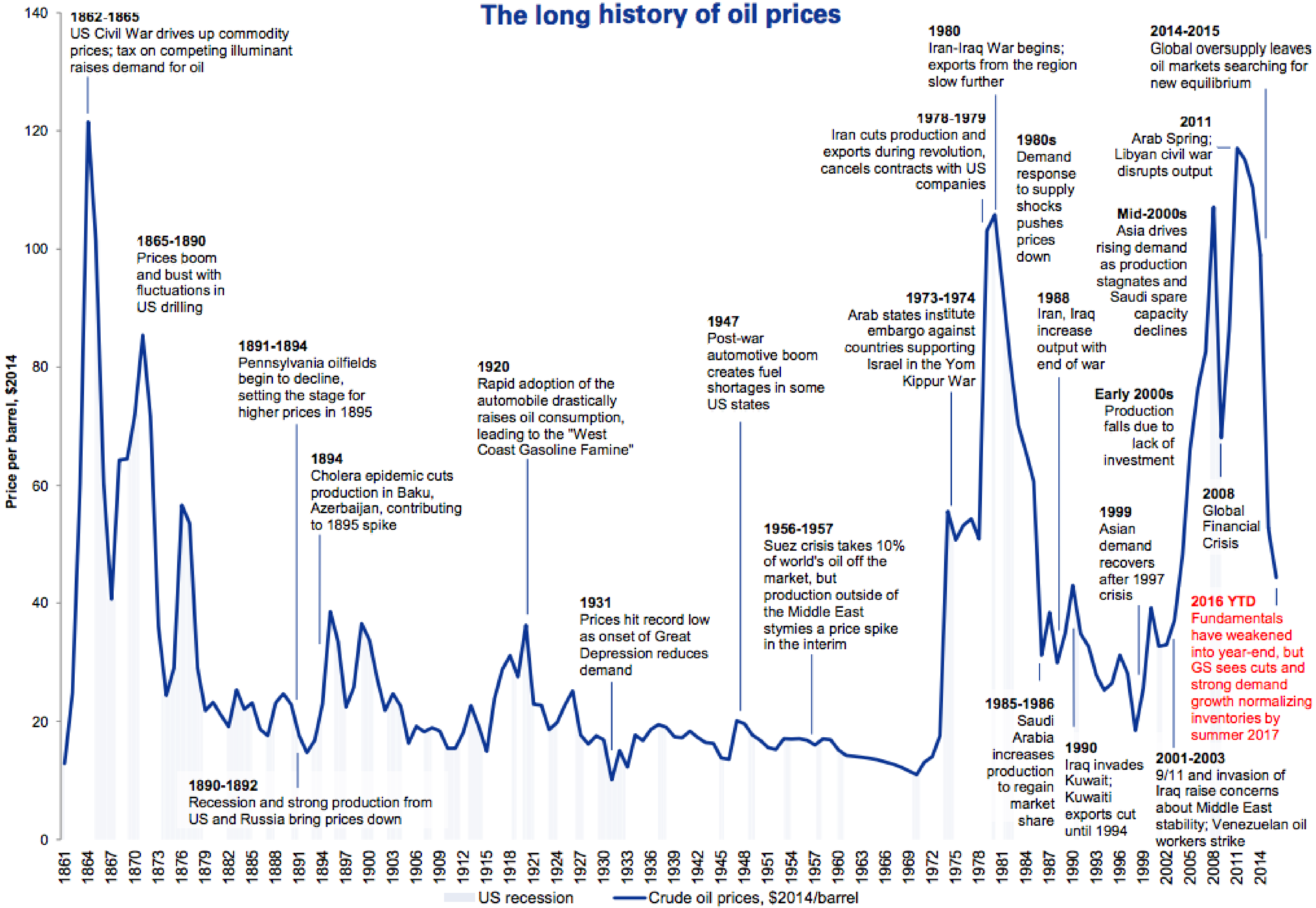
What is bothering Russia?

- Lost of respect.
- Inability to find an agreement on what is and what is not interference in the internal affairs (soft power vs. undermining the state).
- The impossibility of negotiating with West based on geopolitical principles without involving references to human rights and other „Western-liberal“ values.
- Russia is a classic realist actor that does not (want to) understand and recognise the liberal principles of international relations - the non-zero-sum game, cooperation that limits conflict, the primacy of economic over political gains.

- NATO – enlargement vs. expansion.

What to expect?

- Russia wants to be big, important, to have a role in deciding what happens (and what does not happen) in the world – (vs. its real capacities).
- Catherine the Great´s foreign policy minister Alexander A. Bezborodko (1747 – 1799): „…not a single gun in Europe dared to fire without our permission“.
- In 1990s and zero years Russia more or less hesitantly accepts the „West order“ and discourse. From 2014 an effort to confront West (= USA) using all available options – economically, militarily, legally.
- Struggles to apply soft power, threatens with nuclear armaments instead.



An earlier version of this chart appeared on pg. 16 of Top of Mind Issue #52: OPEC and Oil Opportunities.
Note: 2016 price shown is YTD average as of Dec. 19, 2016.
Source for data: BP, NBER/Federal Reserve Bank of St. Louis, Haver Analytics.
Source for annotations: ©James Hamilton, "Historical Oil Shocks," University of California, San Diego, February 2011; various news sources; Goldman Sachs Global Investment Research.

Yeltsin´s era (1991 – 1999)

- Oil prices low (usually below USD20 between 1986 – 2000).
- Government´s desperation for exporting hydrocarbons to get hard currency (export at all costs).
- General economic chaos (economy down by about 40%) drives down oil and gas production (about ½ of Soviet era production), again impacting revenues.
- Privatization for cheap price (Sibneft USD100 million in 1995 – Roman Abramovich, USD 13 billion in 2005) resulted in money extracted by oligarchs. State controls only about 10% of oil production, full privatization of Gazprom (state controls 38%) considered.

Putin´s era

- Dramatic increase in prices of oil.
- State regains the control (not necessarily the ownership though) over fossil fuel production (M. Khodorkovsky and Yukos, 2005 Sibneft/Gazprom Neft – R. Abramovich, 2007 Russneft – M. Guseriev to Oleg Deripaska…).
- Active pipeline policy.
- Increased effort to control pipelines in transit countries (Baltic states, Poland, Belarus, Ukraine, Balkan countries).
- An effort to diversify the consumers.
- Economic situation stabilized, foreign debt paid off, significant reserves – increased manoeuvrability in foreign affairs.
- Traditional customers highly dependent on Russia´s supplies.
- Pushing foreign companies out of the control of production of hydrocarbons (2006 - Shell – Sakhalin II).

Putin´s era

Despite the conflicts cooperation continues.

- 1997 – Yamal pipeline.
- 2001 – Blue Stream.
- 2005 – Start of Nord Stream
- Long term contracts extended.
- Gas trades stable or increasing.

EU – Russia relationship

- From the perspective of the EU, is Russia reliable and predictable supplier?
- How EU manages its dependency on Russia´s energy resources?

Development of crude oil trade

- Soviet oil industry, damaged during WWII, had recovered by 1960s.
- The Druzhba Pipeline – agreement signed in 1959, by 1962 reached Bratislava (SVK), 1965 Litvinov (CZ). Longest oil pipeline in the world (more than 5000 km).
- North branch (PL, Ger), South (UA, SVK, CZ, HU).

- Supply curtailments in 1990, 1992 (Baltic countries), 2007 (Ukr/Rus over fees), 2008 (CZ after US radar…), 1998-1999 8x to Lithuania´s Mazeikiai…

Development of natural gas trade

- Exploration in 1950s, as a by-product of oil production. In 1960s growing production, a standalone industry. Deliveries to the Soviet Republics (Georgia, Armenia…).
- SSSR in need of technology – higher pressure pipelines (vs. the oil) – shipped from Germany and Italy.
- 1960s – Europe in need of energy, but NATO countries embargo on large-diameter pipes (oil and gas). Missing unity, limited affect.
- 1960s – Deliveries to Belarus, Latvia, Lithuania…
- 1967 – Brotherhood Pipeline constructed.
- In 1970s first deliveries to West Europe. (Building on the successes of the construction of Druzhba).
- By 1975 all Russian satellites connected (except for Romania).

Primary Russian Oil and Gas Pipelines to Europe (U)

Politics of hydrocarbons during Cold War

In the West -

- Oil shock, Détente and Ostpolitik (W. Brandt)
- Cooperation with Italy in industrial production, Italian pipes for the Soviet oil, later Italy replaced by Austria as the closest partner.
- Dominance of economic considerations and reasoning (vs. geopolitical concerns).
- Very different position of the U.S.

Politics of hydrocarbons during Cold War

In the East -

- „Socialist division of labour“ (N. Khruschev, 1953/64) – USSR supplied (subsidized) oil and natural gas to the rest of the Soviet Block to ensure dependency and political compliancy.
- In receiving countries of the Eastern Block industries built around cheap energy, very inefficient consumption.
- Export of hydrocarbons to capitalist West to earn hard currency, illustrate the achievements of communist society, and limit the influence of the USA in Europe.
- Adherence to contractual obligations.

= Path dependencies were created.

Politization of gas supplies?

Natural gas prices charged to Russian customers ($/TCM).

	2005	2006	2007	2008
Armenia	$56	$110	$110	$110
Belarus	$46	$46	$110	$125
Georgia	$63	$110	$235	$235
Moldova	$80	$110	$170	$190
Ukraine	$50	$95	$130	$160

Increasing tensions over Ukraine

- Importance of Ukraine for Russia based on culture, spirituality, industry, demography, imperial ambition, agriculture, NATO, corruptive influence „of the West“…
- Leonid Kuchma (1994 – 2005).
    - Frozen prices of natural gas.
    - Delayed payments (debt to Russia).
- 2005 Viktor Yushchenko (result of Orange revolution).
- 2010 Viktor Yanukovych.
- 2014 Petro Poroshenko (result of Euro-Majdan and refused EU association agreement).
- 2019 Volodymyr Zelenskyj.
- Eastern Partnership (2009) – Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine.

Natural gas disputes 2006 - 2009

- Tension increased after Orange Revolution of 2004.
- Ukraine pays USD 50/tcm, Gazprom demanded USD230/tcm.
- Cut off on January 1, 2006, European customers impacted. Flow of gas restored one day later.
- Gazprom accused Ukraine of siphoning gas from transit pipelines, denied.

= Agreement on USD 95/tcm price.

2007 – Russia suggests creating a joint venture to run the transit system, Ukraine prevents that passing a law banning privatisation, sale or lease the system.

Natural gas disputes 2006 - 2009

- Feb 2008 – Gazprom claimed over USD 1.5 billion debts, later on halved supplies for a short period of time.
- Naftogas agreed to pay the debt back.
- Oct 2008 – memorandum on Ukraine paying market price after three years of gradually increased prices.
- After weeks of negotiations on debt and prices for 2009 Gazprom cut off all supplies for Ukraine on Jan 1, 2009. (Gazprom proposed to raise the price to USD 250 from USD 179.5. Ukraine said it was prepared to pay USD 201 and wanted to raise gas transit fees. Gazprom then raised the price again to USD 458).

Natural gas disputes 2006 - 2009

- Russia accused Ukraine of stealing gas for Europe, on Jan 7 PM Putin halted all supplies to and through Ukraine.
- Problems in 16 EU MSs and Moldova for 2 weeks (7.-20.1.2009). Part of the Balkans in a humanitarian emergency, economic damages.
- Lacking infrastructure to redistribute natural gas over the EU (reverse pipelines).
- Wake up call for the EU.

EU (energy) reaction

EU concerned both about Russia´s aggressive foreign policy and its own (eastern part) energy vulnerability.

- 994/2010: N-1 scenario (when the single largest gas infrastructure of country fails) – supplies for protected customers (mostly households + hospitals…).
- 2017/1938: solidarity principle - countries are obliged to help neighbouring countries, to which they are directly connected.
- New infrastructure – reverse flows, gas storages, LNG terminals.
- Measures increasing flexibility and transparency of the market.

= EU focused on protecting individual MS or some smaller group (focus on market rules).

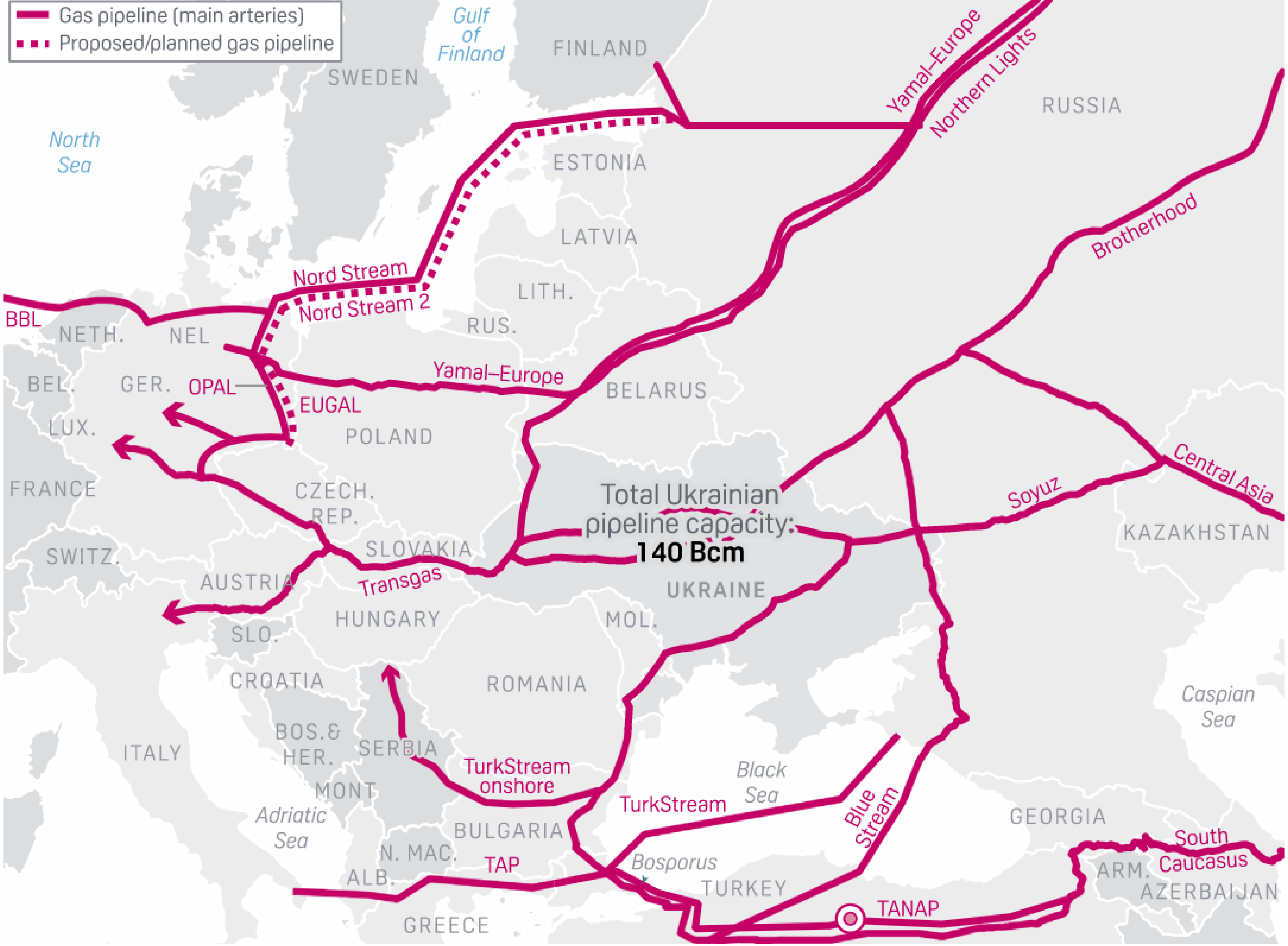
Pipeline policy

- Yamal LNG (2017).
- Power of Siberia (2019).

- Nabucco (cancelled in 2012).
- TANAP (2018)/TAP (PCI, 2020).

- TurkStream (replacing South Stream) (2020).
- Nord Stream (2012).

- Ukraine problem both for Russia and the EU.
- Diversification feedback loop.


Gas pipeline (main arteries)
Proposed/planned gas pipeline
Gulf of Finland
FINLAND
SWEDEN
RUSSIA
North Sea
ESTONIA
LATVIA
LITH.
RUS.
Yamal–Europe
Northern Lights
Brotherhood
Nord Stream
Nord Stream 2
BBL
NETH.
NEL
BEL.
GER.
OPAL
EUGAL
Yamal–Europe
BELARUS
LUX.
POLAND
FRANCE
CZECH. REP.
Total Ukrainian pipeline capacity:
140 Bcm
Soyuz
Central Asia
KAZAKHSTAN
SWITZ.
SLOVAKIA
AUSTRIA
Transgas
UKRAINE
HUNGARY
MOL.
SLO.
CROATIA
ROMANIA
Caspian Sea
BOS.& HER.
SERBIA
ITALY
TurkStream onshore
Black Sea
MONT.
TurkStream
Blue Stream
Adriatic Sea
BULGARIA
GEORGIA
South Caucasus
N. MAC.
TAP
Bosporus
ARM.
AZERBAIJAN
ALB.
TURKEY
TANAP
GREECE

Nord Stream (2010 – 2012)

- Nord Stream (2 lines of 55 bcm/y) is not restricted by TPA but both OPAL (50 % of its 35 bcm/y) and NEL (35 % of its 20 bcm/y) partially are.

Euromaidan and Revolution of dignity

- 2013 Maidan Uprising over EU-UA Association Agreement (Viktor Yanukovych´s government overthrown) -> 2014 Revolution of Dignity.
- 2014 Russo-Ukrainian War -> Proto-states Donetsk and Luhansk, annexation of Crime.

⇒ Diplomatic relations (such as bilateral summits) between the EU and Russia frozen.

⇒ Sanctions (individual measures, restrictions on economic relations with Crimea and Sevastopol, economic sanctions, restrictions on economic cooperation).

Ukraine

- 2010 Gas market law (unbundling, TPA, transparency, NRA, price reform) -> Energy Community.
- 2012-2013 foreign IOC invited – Shell, negotiations with Exxon, RWE, Chevron...
- Direct imports of gas from Russia ceased. Imports from Poland, Slovakia, and Hungary instead.
- Transit limited with feeble perspective.
- Naftohaz with international supervisory board (later replaced).
- Consumption from around 50 bcm in 2013 to 30 bcm in 2021.
- UA accepting some EU decarbonization ideas and targets.

2014 gas „stress tests“

- Different scenarios, in particular a complete interruption of Russian gas imports into the EU for a period of 6 months.
- EU MSs and neigbouring countries included.
- Results – substantial impact expected, with the Eastern MSs and Energy Community countries affected the most.
- Non – cooperative scenario: Finland, Estonia, FYROM, BiH, and Serbia would miss 60%+ of the gas they need, which would result in some customers with no supplies.
- Cooperative (market) scenario: no households (protected customers) without gas.

Nord Stream II.

Highly politicized, several criticisms:

- NS2 will reinforce Gazprom´s dominance in Europe and cement the position of natural gas in the EU´ energy mix.
- It will undermine the security and financial position of Poland, Slovakia and Ukraine.
- Cleavages between Germany and Poland/Slovakia/Baltic countries; between Germany/Austria and US; between US and the EU.
- US sanctions (starting in 2017, applied in 2019 - Allseas) aimed at companies building the pipeline.

Nord Stream II.

- Legal disputes – UN convention on the Law of the Sea vs. Third liberalization package applied to the EU territorial waters = Gas directive changed (2019) but it is up to MSs to implement the rules on TPA, unbundling, and tariff transparency.
- Nov 2021 BNetzA suspended the certification of NS2 company as an ITO of the pipeline. Operator needs to be „organized in a legal form under German law“.
- 19/2022 – sabotage of the pipelines.

Schroderization

- G. Schröder (1998 – 2005, Rosneft, Nord Stream AG, nominated to Gazprom)
- Francois Fillon (former French PM) – Zarubezhneft and Sibur.
- Paavo Lipponen (former PM of Finland) – lobbyist for Nord Stream 2.
- Karin Kneissl (former Min. of foreign affairs of Austria) – Rosneft.
- Wolfgang Schussel (Former PM of Austria) – Lukoil.
- Hans-Jorg Schelling (Former Min of Finance of Austria) NS2.

EU – Russia Energy Relations

- Partnership and Cooperation Agreement.
- Energy Charter Treaty.
- Partnership for Modernisation.
- EU – Russia Energy Dialogue.

- Early Warning Mechanism.
- Gas Advisory Council.

EU – Russia Energy Relations

EU – Russia Energy Dialogue (launched in 2000) - to have a legally binding agreement with Russia (similar to ECSC).

4 thematic groups:

- Energy strategies, forecasts, and scenarios group.
- Market development group.
- Energy efficiency group.
- Gas Advisory Council.

Suspended after Russia´s annexation of Crimea.

EU – Russia relationship

- From the perspective of the EU, is Russia reliable and predictable supplier?
  - Decent (partially false and mainly legalistic) reputation of Russia – destroyed by the RU/BY x UA war.
- How EU manages its dependency on Russia´s energy resources?
  - Common, flexible, and interconnected market.
  - Rules on security measures and solidarity in gas sector.
  - Bilateral forums and arrangements.
  - Diversification.
  - Interdependence.

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