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Russia and the Politics of Gas Market Integration in Europe

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Main messages

- Europe's problem with Russian gas is not over-dependence but political divisiveness
- Divisiveness is exacerbated by market segmentation
- Europe would derive geopolitical benefits from an integrated, competitive gas market
- There are foreign policy dimensions to Germany's opposition to gas market integration

Three dimensions of energy security

- Disruption risk
  - Macro-economic cost of energy supply disruptions
- Scarcity risk
  - Long-term price of energy
- Dependence risk
  - Burden on foreign policy

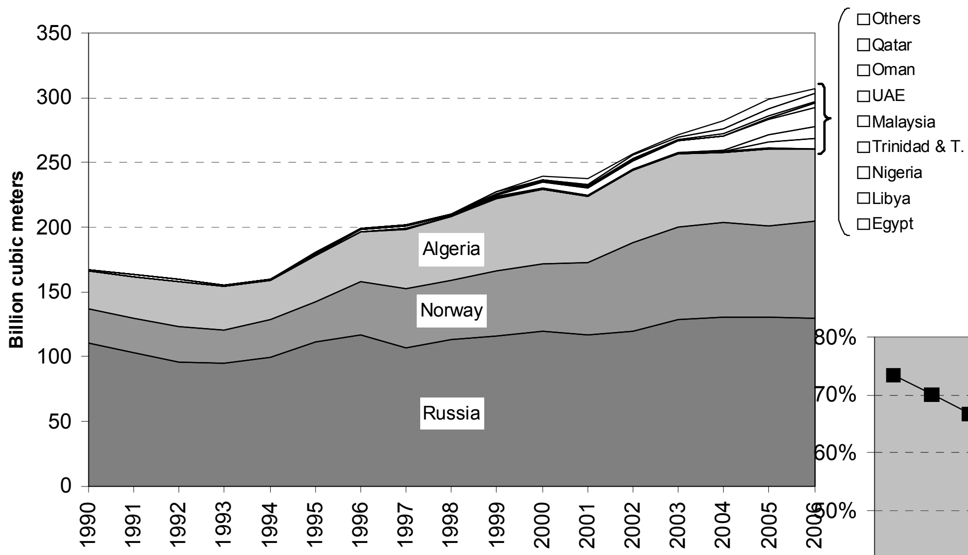
- We focus here on the “dependence risk”
  - The EU-Russia gas relationship is one of the main barriers to a common European foreign policy approach to Russia

Politics of the EU-Russia gas relationship

- 1980s: gas shielded from cold war politics
  - Strong US resistance to Europe's "dependence" on USSR
  - Keeping gas out of the cold war key condition for the relationship to develop
- 2000s: Putin's Russia broke the implicit contract
  - Politicisation of Gazprom's management
  - Gas export policy at the service of Russia's European policy
  - Development of an ambitious European policy based on exploiting and reinforcing Europe's divisions
- EU is still wondering how to respond
  - "Dependence is a threat" v. "Russia is reliable"
  - Energy diplomacy towards Russia is failing – "EU-Russia energy dialogue"; ECT; new PCA negotiations

European gas supply has been diversifying

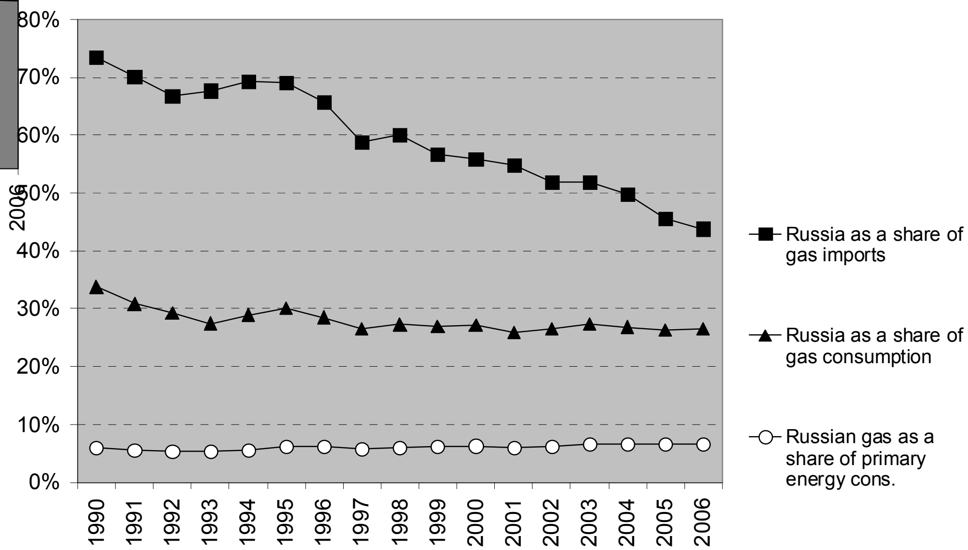
…Yet Russian gas is more and more divisive in Europe



Source: Eurostat

Since 1990, 80% of increase in gas imports is non-Russian

Russia's share of imports has been halved since 1980



Source: Eurostat; BP Statistical Review of World Energy

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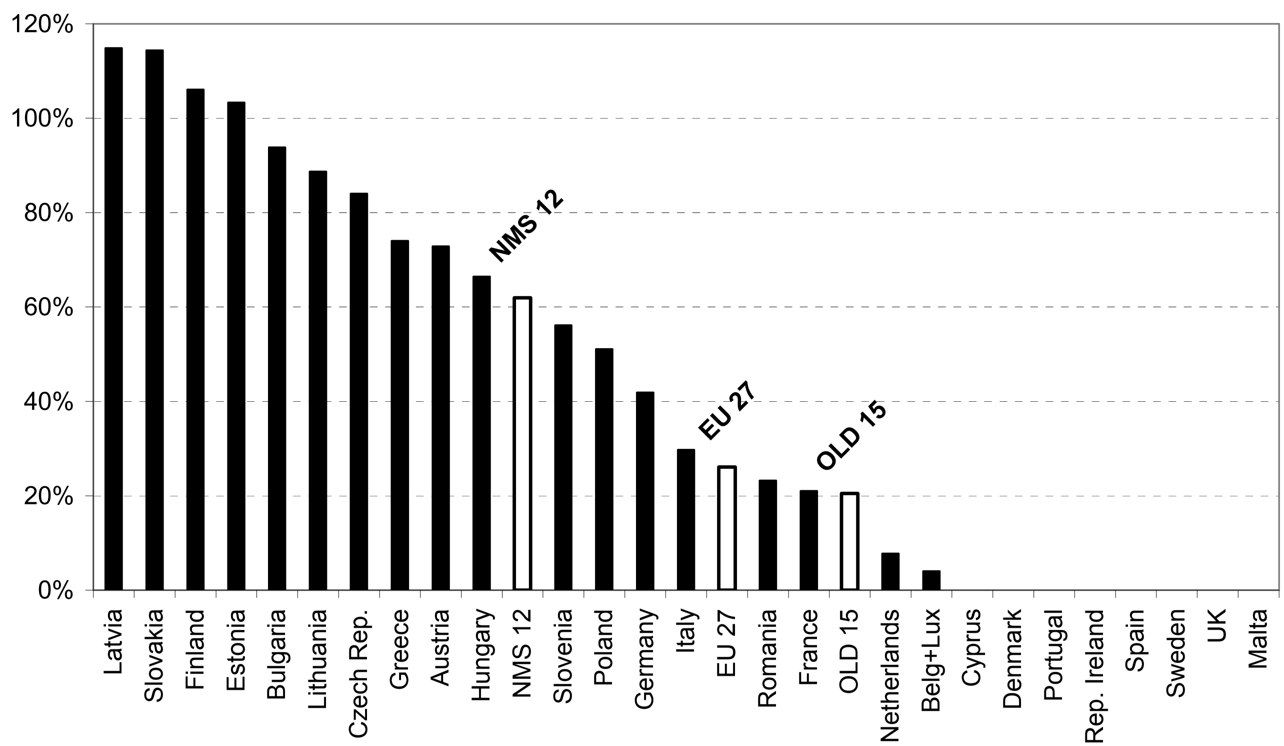
Supply diversity is in Western Europe

Eastern Europe *is* highly dependent on Russia

Imports from Russia as a share of primary gas supply



Sources: BP Statistical Review; Eurostat

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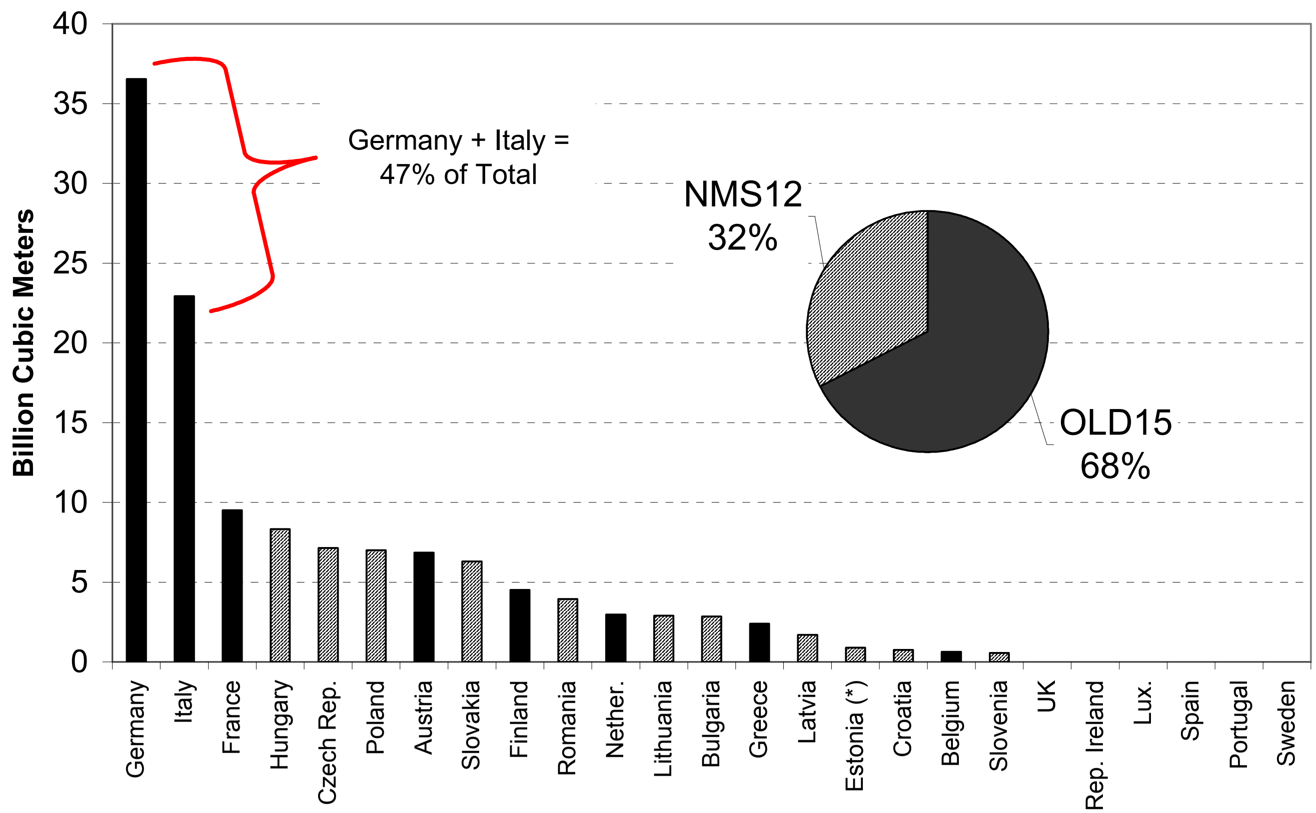
Western Europe takes the bulk of Russian gas

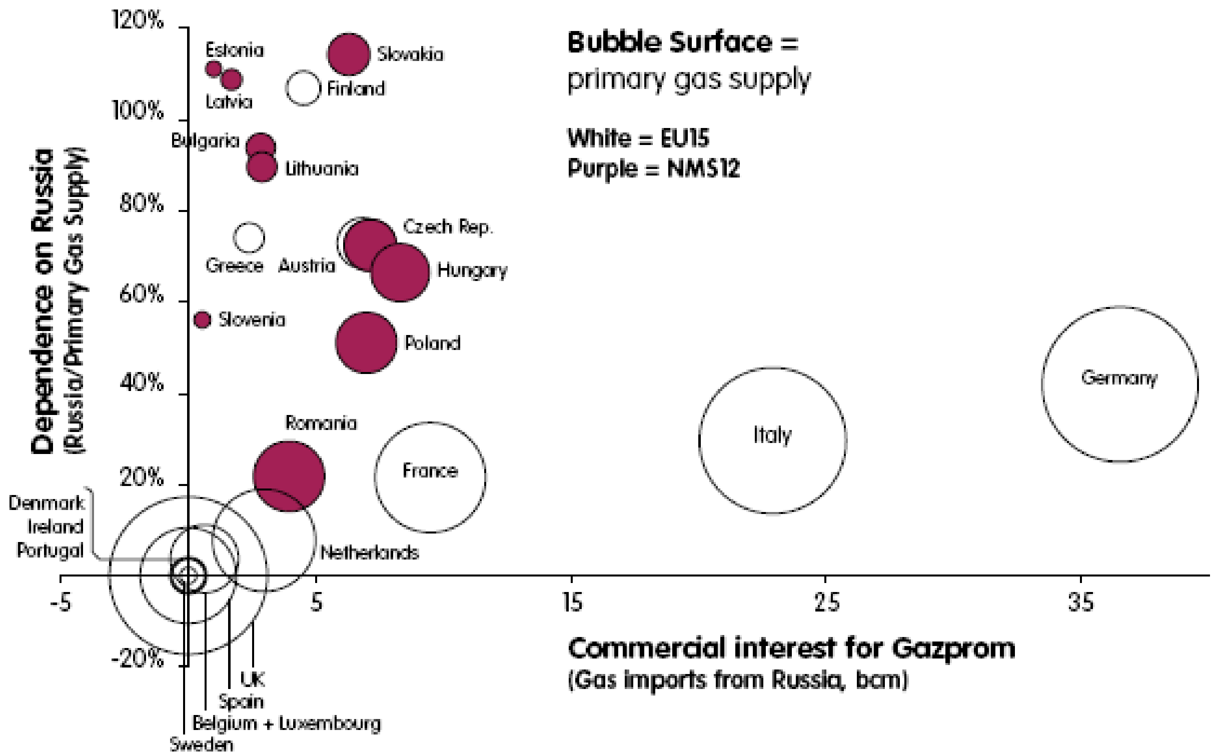


Sources: BP Statistical Review; International Energy Agency

(*) 2004

Geopolitics of segmented EU gas market

Segmented gas market is key to Russia's foreign policy towards Europe – *strategic partnerships with key nations*



Source: BP Statistical Review; Eurostat

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Market integration would help reduce the divisiveness of Russian gas

- Germany and Italy merged into a highly diversified Western European market
- Supply diversity could move eastward
  - Poland, Hungary, Czech Rep. -- *not Baltic states*
- Increase collective supply security
  - A wider market means more arbitrage possibilities – reallocation of supply in time of crisis
- Change the conditions of access to Russian gas
  - Bilateral import contracts would be "Europeanised"

Resistance to market integration

- "Traditionalists vs. New Economy" (2001)
  - Liberalisation / integration compromises "energy security"
  - Little has changed – at least in Germany
- EU / economists' view: anti-competitive behaviour
  - Defending dominant positions on national markets
- Foreign policy dimension – *Insights from Germany*
  - Preserving its "strategic partnership" with Russia…
  - …means keeping the gas relationship entirely bilateral
  - Avoiding at any cost gas "solidarity" with Eastern Europe – Because they behave "irresponsibly" vis-à-vis Russia
- German government more "traditionalist" than cpies.

Resistance to market integration (2)

- "Gas market liberalisation in Europe is the most stupid idea in modern economic history."
  - D. Medvedev, chairman of Gazprom (2006)

Position on Russia v. position on unbundling

ECFR EU-Russia Power Audit

Foreign policy attitude towards Russia (ECFR)	Oppose 'ownership unbundling'	Support 'ownership unbundling'
Trojan horses		
Cyprus	•	
Greece	•	
Strategic partners		
France	• **(leader)**	
Germany	• **(leader)**	
Italy		
Spain		•
Friendly pragmatists		
Austria	•	
Belgium		•
Bulgaria	•	
Finland		•
Hungary		
Luxembourg	•	
Malta		
Portugal		
Slovakia	•	
Slovenia		•
Frosty pragmatists		
Czech Republic		
Denmark		•
Estonia		
Ireland		
Latvia	•	
Netherlands		• **(leader)**
Romania		•
Sweden		• **(leader)**
United Kingdom		• **(leader)**
New cold warriors		
Lithuania		
Poland		

Source: Categorising of EU countries according to their foreign policy towards Russia, from: Mark Leonard and Nicu Popescu, *A Power Audit of EU-Russia Relations* , London: European Council on Foreign Relations, 2007, p. 26-50. Position towards ownership unbundling of gas transmission from supply activities, from: Letter from the Ministers in charge of energy of eight EU member states to Angelika Niebler, Chairwoman of the ITRE Committee, European Parliament, dated 29 January 2008; "'Third Option' mooted on energy liberalisation", Euractiv.com, 27 November 2007.

Izvestia "Русский вопрос" расколол Европу" (2 Sept 2008)

Foreign policy attitude towards Russia (Izvestia)	Oppose 'ownership unbundling'	Support 'ownership unbundling'
Russophobes		
Poland		
Lithuania		
Latvia	•	
Estonia		
UK		• **(leader)**
Sweden		• **(leader)**
Moderate Critics		
Czech Republic		
Hungary		
Romania		•
Denmark		•
Pragmatics, Centrists, Neutrals		
Slovakia	•	
Slovenia		•
Bulgaria	•	
Spain		•
Finland		•
Netherlands		• **(leader)**
Austria	•	
Ireland		
Portugal		
Malta		
Russia's Lobbyists		
France	• **(leader)**	
Germany	• **(leader)**	
Italy		
Belgium		•
Luxemburg	•	
Greece	•	
Cyprus	•	

Source: Categorising of EU countries according to their foreign policy towards Russia, from: Izvestia, "Русский вопрос" расколол Европу ("Russkii vopros" raskalol Evropu), http://www.izvestia.ru/politic/article3120068/ (2 Sept 2008). Position towards ownership unbundling of gas transmission from supply activities, from: Letter from the Ministers in charge of energy of eight EU member states to Angelika Niebler, Chairwoman of the ITRE Committee, European Parliament, dated 29 January 2008; "'Third Option' mooted on energy liberalisation", Euractiv.com, 27 November 2007.

Concluding thoughts

- Market integration is just one element
  - Supply security standards – investment in supply security in Central & Eastern Europe
- Building a gas market should be a (real) priority
  - Will the “3rd package” deliver?
  - Who wants to spend political capital on it?
- How to overcome German resistance to market integration and European solidarity?
- Will energy policies reflect the political cost associated to Russian gas? How?