

Russian-EU Energy Interdependence and Security in Europe

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Abstract -

Does the current level of economic interdependence between the Russian Federation and members of the European Union (EU) promote stability in Europe? As a key component of national security, energy security is a high priority for all states. While overall EU dependence on the Russian Federation for such critical needs as oil and gas does pose a potential threat to the national security of some EU members, the reality is that this dependence will continue through at least the next decade.

If the EU is overall dependent on Russian energy imports then one could say that Russia is highly dependent on the income from exporting oil and natural gas to the EU. Despite the economic recovery that Russia has seen over the 13 years, since the Russian economic collapse in 1999, Russia has failed to diversify its economy. With the federal budget of the Russian Federation being at least 50 percent dependent on the income from energy exports, establishing demand security for those critical commodities should have been a very high priority over the past decade. Unfortunately, Russia's state owned national champion Gazprom has instead been used to finance the government and as a tool of international diplomacy to either reward or punish European states for their compliance with Russian positions.

The failure of Russia to diversify its economy and the failure of the Russian energy sector to diversify its consumer base have resulted in the Russian federal government being highly dependent on energy exports. Additionally, with nearly 80 percent of Russian energy exports flowing to the EU this means that the Russian federal government is highly dependent on energy exports to members of the EU. If interdependence is defined as two states being dependent on one another for trade then Russia and the EU share interdependence in the energy market.

Despite previous attempts to unite EU member states in critical policy areas such as energy policy over the past decade, the Russian Federation has been able to bypass EU structures and engage EU members individually to establish dominance in the energy market. However, the Ukrainian gas crisis of 2009 exposed the vulnerabilities of the EU to supply disruptions and gave individual EU member states the motivation to work more closely together to improve overall EU energy security. This basic change in the willingness of individual EU member states to

prioritize overall EU goals in the energy market represents a fundamental paradigm shift. While not every EU member supports the concept of a common EU energy market to the same degree, this shift has been significant enough to challenge Russian influence in the EU marketplace.

Introduction -

In this paper I argue that the greatest chance for ensuring future stability in Europe lies with the ability of the European Union (EU) and Russia to sustain the interdependence of the Russian - EU energy market. Interdependence which ensures the reliability of the supply of Russian energy imports to Europe as well as the reliability of the demand for those exports from Russia would serve to stabilize the relationship. However, a relationship which does not ensure both will lead to continued insecurity and mistrust. Only when European nations feel assured that their energy import supply from Russia is secure and reliable and Russia feels that the demand for its energy exports to European countries is secure will such interdependency serve to promote security in Europe. (Casier, 2011) It would not be sufficient only to take actions that would guarantee the supply of natural gas for Western Europe without considering where this supply came from. Nor would it improve the prospects of future security in Europe if the demand for Russian energy exports was secured by contracts with China. Only with a fine balance where Europe feels confident that its energy imports are secure and reliable AND the Russian Federation feels that the demand for its energy exports to Europe are guaranteed, could Russia and the EU begin to work together to solve other security problems on the continent.

The next section of this paper establishes the importance of energy exports to the economic health and national security of the Russian Federation. Then I discuss the realist and liberal points of view with regard to economic interdependence and the proclivity of states to wage war. Within this section I introduce Dale C. Copeland's theory of trade expectations, and highlight

how Russian and EU leaders' expectations of future trade in the energy market drive the relationship between Russia and the EU. Then I discuss energy as a critical component of national security in Europe. This section outlines the current state of energy interdependence between Russia and the EU. Drawing conclusion from EU's internal analysis of critical events such as the Ukraine gas crisis of 2009, I demonstrate how Copeland's theory of trade expectations could be used to explain the current insecurity felt in both Russia and the EU. This section also discusses the engagement strategies of both Russia and the EU and explains why the strategies of both sides have resulted in greater regional instability. I will use the example of the interruption of Russian natural gas supplies to the Ukraine in 2009, to show how Russia manipulates individual countries in order to attain its foreign policy goals at the expense of decreased demand security of its own energy exports.

The final part of this paper is a discussion the potential strategies of engagement between the EU and Russia vis-à-vis energy security. Despite apparent disharmony among EU members with regard to a unified EU –Russia energy policy, the EU Commission has taken the initiative and is working to enforce competition rules for the EU common energy market. (Vaïsse & Kundnani, 2012) This policy encourages continued engagement, but emphasizes European unity over bilateral relations with Russia.

Importance of Russian Energy Exports

With the unpredicted and relatively sudden collapse of the Soviet Union, a new era began. The threat of war that had hung over the continent of Europe for more than half a century vanished virtually overnight and hopeful governments on both sides of the Atlantic began making plans about how they would spend the peace dividends that would result from the end of

the Cold War. Initially, the weakened Russian Federation suffered from severe economic turmoil during the transition from a command economy to a free market system. Despite the bloodless revolution that divided the Soviet Union, into 15 sovereign nations, the economic and political losses that the Russian Federation suffered in the aftermath have had a profound effect on Russia that persists until today. Although the Russian economy recovered to a position of relative strength over the last decade, the sense of vulnerability felt by Russian political elites continues to define Russia's national security strategy and more specifically Russian energy policy, which is a cornerstone of Russian economic and political power.

Almost two and a half decades after the collapse of the Soviet Union we look back and ask ourselves, since the collapse of the Soviet Union, has the continent of Europe been more, or less secure than in the previous half century? The answer to this question lies firstly in one's definition of the word secure and secondly to the question of from whose point of view the security of Europe is evaluated. Security is most simply defined as the state of being free from danger or threat; in discussing the security of the European continent we are really discussing the national security of its component nations. Since the end of World War II most of the nations of the European continent have pursued their national security objectives through membership in either the world's most powerful security alliance, the North Atlantic Treaty Organization (NATO) or its rival the Warsaw Pact. Prior to the collapse of the Soviet Union and Warsaw Pact, national security was viewed primarily as freedom from the threat of open conventional or nuclear war. Mearsheimer attributes the relative peace in Europe prior to the end of the Cold World War to three factors. The bi-polar distribution of military power in Europe, rough conventional military parity between those two poles – NATO and the Warsaw Pact- and the

enormous arsenals of nuclear weapons controlled by the leaders of those two poles, Russia and the United States. (Mearsheimer, 1990, p. 3)

With the end of the Cold War this balance has been upset. There has been war in the Balkans and Caucasus regions and internal armed conflict within Russia. Several of the former Soviet Union's Warsaw Pact "allies" have joined either NATO or the EU or both. Although the United States has had a decreasing military presence in Europe over the past decade there is no illusion that the Russian Federation has military parity with the rest of Europe. Despite Russian military spending of almost 4 percent of GDP in 2012, just the top two EU members in military spending, France and the United Kingdom spent nearly twice as much as the Russian Federation. Additionally, demonstrations of the United States' ability to rapidly project military power into the region during the Kosovo War also reminded Russia that while massive US troop formations were no longer present in Europe, they could return very quickly. (Antonenko, 1999, p. 8)

Energy Interdependence as a Component of Russian National Security

National security is the requirement to maintain the survival of the state through the use of economic power, diplomacy, power projection and political power. Accordingly, in order to possess national security, a nation needs to possess economic security, energy security, environmental security, etc. Security threats involve not only conventional foes such as other nation-states but also non-state actors such as violent non-state actors, narcotic cartels, multinational corporations and non-governmental organizations; some authorities include natural disasters. In the United States high national debt is being often cited as "the most serious threat to our national security". If one were to examine Russian perceptions of its own national security

it would be no surprise that Russia felt deeply threatened during the first decade after the collapse of the Soviet Union. This sense of threat reached its peak in 1999.

The economic crisis and collapse of the Russian ruble, ongoing internal conflict in Chechnya, and the expansion and offensive military operations of Russia's former military rival NATO in the Balkans. All of these security threats occurring during the same relative time period worked together to make the Russian political leaders question their own national security. By October 1998, millions of Russians had already lost their life's savings. A poor Russian harvest resulted in Russia's official request to the United Nations for international humanitarian food aid. As many as 100,000 people protested in the streets in Moscow and tensions were building over NATO's involvement in the Kosovo conflict in the Federal Republic of Yugoslavia. On 23 March 1999, despite Russian opposition to Western involvement in Kosovo, NATO began its bombing campaign. The campaign would ultimately result in a NATO ground invasion of Kosovo and a standoff between Russian and NATO forces that could have started World War III. Then NATO Supreme Allied Commander Europe (SACEUR), General Wesley Clark reportedly ordered NATO forces under British Lieutenant General Mike Jackson to seize the Prishtina Airport from Russian forces on 12 June 1999. Fortunately for the world, a junior officer of the British Army named James Blunt, refused the order of the NATO Commander to attack Russian forces at Prishtina airport. Some Russian analysts, convinced that NATO and Russia came close to direct military confrontation, have compared the situation to the Berlin and Cuban missile crises.¹ (Antonenko, 1999, p. 125) While the confirmed numbers of people killed in Kosovo are still elusive, and broader conflict was avoided, the world would have to reevaluate our benefits from the "peace dividend".

¹A point made by many Russian analysts, including Alexi Arbatov, 'NATO glavnyaya problema dlya evropeiskoi bezopostnosty', *Nezavisimaya Gazetta*, 16 April 1999.

It is important to understand the deep sense of crisis felt in Russia during this time. Not only the elites of the country but the population in general was feeling marginalized, isolated under economic duress and threatened militarily both from abroad and internally. For the average American to get a sense of the insecurity experienced by Russians during this time period one could make a crude comparison. Imagine the perceptions that Americans would have of their own national security if the 2008 collapse of the housing market and financial markets and the destruction of the world trade center occurred within the same year and then the following year an internal armed conflict broke out inside the U.S. While unrealistic to the average American this is the severity of the crisis that Russians faced. Each of these events occurring by themselves would be destructive, but occurring together would elicit panic and calls for drastic changes in the government. This is what happened in Russia, a drastic change in the government.

Russian political elites were increasingly aware of Russia's isolation and inability to meaningfully influence NATO policies, even on matters of national security within countries bordering Russia. (Antonenko, 1999, p. 125) With little ability to influence these conflict situations politically, the Russian government reacted with its only remaining tool, force. The collapse of the Russian ruble was closely tied to the decline in income from Russian crude oil and gas exports. The perceived threat from NATO was directly attributable to the expansion of NATO and NATO offensive military operations in the Balkans. The internal threat from Chechnya was caused by separatists in the Northern Caucasus. Two of Russia's security threats could be solved by force. Increasingly violent offensive campaigns in Chechnya have, for the time being, convinced the people of Russia that Chechnya no longer represents a threat to Russian national security. Russian intervention at Prishtina in 1999, military basing agreements with Armenia and the 2008 invasion of Georgia have at least temporarily halted the expansion of

NATO. The economic situation in Russia began to improve by the end of 1999 with the gradual increase in demand for Russian oil and gas exports.

A critical factor in this analysis is the realization of the key importance of Russian energy exports to the Russian economy and stability of the federal government. Despite systemic problems in the transition from a command economy, the ultimate reason for the collapse of the Russian economy was the decline in demand of Russia's two most valuable commodities -crude oil and nonferrous metals- resulting from the Asian economic crisis which began in 1997 (Gaidar, 2004, p. 51). The decline in Russian crude oil exports alone from 1997 to 1998 was nearly 42 percent. Despite attempts to stabilize the economy by the embattled President Yeltsin, and billions of dollars from the International Monetary Fund (IMF), increasing inflation, high unemployment and loss of confidence of global investors would ultimately bring about the collapse of Russian economy. (Gaidar, 2004, p. 41) According to the famous quote of Albert Einstein, "the definition of insanity is doing the same thing over and over again and expecting different results". So it could have been considered irresponsible if the Russian government had not taken decisive actions to improve the security of its energy export markets.

Russian Resurgence

On the ninth of August 1999, President Yeltsin appointed Vladimir Putin as the acting Prime Minister of Russia. With the gradual improvement in demand for Russian crude oil and recovery of oil prices throughout 1999, Putin was in a great position to lead the Russian Federation out of the deepening darkness it had experienced for the previous decade. On December 31, Putin became acting President of the Russian Federation upon the sudden resignation of President Yeltsin. Since then, the Russian Federation has regained some of its

status a superpower, at least regionally. This re-emergence came largely because of skyrocketing energy prices and increasing demand from Europe, but it was not an accident. In his thesis Putin discussed the importance of Russia's natural resource wealth in Russia's energy policy. He outlined his view of the appropriate role of the Russian state, and of vertically integrated financial-industrial groups, particularly in the oil and gas industry. (Putin, 1999) As president, Putin put into action the basic principles outlined in his thesis, effectively nationalizing the oil and gas industry in order to ensure that the profits from energy exports would be used to shore up the still weak Russian economy.

Having briefly explored the insecurity experienced by the Russian Federation during the first decade after the collapse of the Soviet Union and the importance of Russian energy exports to the Russian economy and thus stability of the Russian Federation, I turn to the heart of this discussion, which is examining the relationship of energy interdependence between Russia and the rest of Europe to the overall security of Europe. This relationship is characterized by interdependence, which is to say, mutual dependence. Russia is dependent on revenues generated by energy exports to Europe and European nations are to varying degrees dependent on Russian energy imports. When this dependence remains stable both economies continue to benefit from the relationship, but events since 2009 have raised doubts on both sides of the reliability of the other. As was demonstrated during the Ukrainian gas crisis of 2009, disruptions in the market can have serious economic consequences. More importantly however was the loss of confidence in the Russia's reliability as a trading partner.

Theories of Interdependence and Energy Security in Europe

Because energy security is an integral component of modern national security, exploring the energy relationship between the EU and Russia gives insight into the prospects for improving the overall security of Europe by stabilizing the energy interdependence between Europe and Russia. In this paper I explore the liberal and realist theories of international relations to make the argument that, in the case of European security, increasing economic interdependence between Russia and Western Europe will decrease the prospects for conflict and war in the future. Liberal theory argues that increasing economic interdependence lowers the probability of war because the high value placed on trade outweighs any gains that could be made by war. Realist theories dismiss this argument and assert that interdependence has the opposite effect. According to realist theory high interdependence, meaning mutual dependence increases the probability of war. Realist theory contends that states operate in an anarchic system where individual states must constantly worry about their own security. (Waltz, 1979) In this anarchic system a high level of dependence is seen as vulnerability and gives states incentives to wage war to secure vital materials or to secure markets for their vital exports.

While there is no expectation that Europe would be willing to wage a conventional war to secure its energy imports, there is a tipping point at which European countries would become more likely to seek alternative sources of energy supply. It could be that this tipping point was already reached during the 2009 Ukrainian gas crisis. The less sure the countries of Europe are in Russia's ability to supply critical energy imports, the more likely they are to seek other sources of supply. Even though these alternate sources of supply may come initially at a higher economic price, European countries gain the benefit of improved energy security and thus national

security. Although EU efforts to diversify their energy supply are not as destructive as a conventional war would be, the loss of income to Russia from declining energy exports to Europe is having and will continue to have a destructive effect on the Russian economy.

The greatest danger comes from Russian insecurity. With the economic health of Russia so reliant on energy exports to Europe in particular, the prospects of a long term decrease in demand from Europe greatly increases Russian feelings of insecurity. Despite having over a decade of cash surpluses from energy exports, Russia has failed to take any concrete measures to expand its market share in other regions of the world, such as Asia. Securing additional customers outside of Europe, either in Asia through pipelines or on the world market through increased liquefied natural gas (LNG) capacity, requires both massive financial investments and significant time. Russia has chosen instead to use profits from the oil and gas industry to fund the federal government. In the short term it remains more cost effective for Russia to make attempts to repair their damaged image as a reliable energy supplier than to make the financial commitments needed to expand the customer base for their energy exports.

Exploring Copeland's Theory of Trade Expectations

I will apply Dale Copeland's theory of trade expectations (Copeland, 1996) to the discussion of EU Russia interdependence in order to make the case that a well-managed interdependency between Russia and the EU would promote overall regional stability. Copeland's theory maintains that with regard to economic interdependence a country's expectations of future trade are actually more important than the current trade levels. Examining the situation at hand between the EU and Russia, a simple example of how the theory of trade

expectations can impact stability is the interruption of gas exports to Ukraine in 2009. After gas imports to Europe were interrupted, the ability of Russia to fulfill its obligations of gas imports to Western Europe came into question. That is to say that Europe's expectations of future energy imports from Russia were lowered causing insecurity in Europe. Would Russia accidentally or purposefully interrupt gas supplies in the future? This question is of critical importance to Western European economic stability and thus security. At the opposite end of the equation are Western European plans to build a series of pipelines from the Caspian Sea Basin in order to bypass Russia as well the construction of LNG terminals and other measures to diversify their supply of natural gas. This undermines Russia's expectation that the demand for their energy exports is secure and creates a feeling of insecurity.

Europe's Energy Situation

Even as EU expanded, it has worked to engage its former rival Russia by trying to develop greater economic and political interdependence between Russia and the EU. While much of the economic and political expansion of Europe into Russia was the result of capitalist markets expanding into the former closed Russian marketplace, there was also a significant and conscious political effort to assist the Russian economic and political systems in making a successful transition from a closed command economy to a democratic free market system. However, despite initial moves towards democracy and cooperation with the West, the humiliation and loss of its status as a superpower, perceived aggressive expansion of its former rival, the North Atlantic Treaty Organization (NATO) and severe economic problems would push Russian elites to view themselves as being threatened.

The Partnership and Cooperation Agreement (PCA) has provided the legal framework for engagement between Russia and the EU since 1997 and generally guides bilateral relations between Russia and EU member states. In addition to providing the framework for EU relations with Russia, the PCA was intended to develop a set of common objectives between Russia and the EU across a broad variety of policy areas. The PCA greatly benefitted Russia at a time when its economy was struggling by liberalizing trade based on Russia receiving most-favored-nation treatment, but did little to synchronize the policy approaches of EU members. Energy policy in particular, was and continues to be an area where EU members are reluctant to compromise their national interests in favor of overall EU ones. The 1999 EU common strategy was an attempt to change this trend and focused on developing a greater sense of cohesiveness between EU members with regard to critical policy areas such as energy policy. However, the continued unwillingness of EU members to align their national policies with EU goals has led most observers to view this common strategy attempt as a failure. (Fraser, 2012, p. 146)

Partly in recognition of the ineffectiveness of the PCA and 1999 EU common strategy, the EU and Russia began working to redefine their strategic relationship based on a concept of four 'common spaces' (Economy, Home Affairs, External Security and Education). The EU's goal has been to bind Russia into an interconnected system to help normalize interactions between Russia and the EU. Despite an intense and frequent multi-level engagement process between heads of state, members of parliaments and dozens of working groups these efforts have failed to yield any significant progress.

Instead Russia has used its position as a major energy provider for Europe to pursue a process of bilateral interaction with individual EU members. By taking advantage of European

trade liberalization and continuing to work outside of EU structures to create special bilateral deals with individual EU members, Russia further weakens the EU’s ability to engage Russia with a united voice. (Fraser, 2012, p. 149)

The European Union composed of its 27 member states is an economic power house and trade and investment between the EU and Russia is closely tied. The EU is Russia’s number one trading partner. In 2011 almost 46 percent of all Russian exports went to the EU, almost 36 percent of goods imported into Russia came from the EU. Nearly 42 percent of Russia’s total trade volume for 2011, or 248.9 billion euros was with the EU. While the EU is the number one trading partner for the Russian Federation, Russia is the number three trading partner for the EU with Russian trade representing 9.4 percent of the EU’s total trade in 2011. (Commission, EU-Russian Trade Statistics, 2013)

If one considers what is being traded between Russia and the EU then it is important to note that 79 percent of goods imported to the EU from Russia fall under the standard international trade classification (SITC) 3 which is mineral fuels, lubricants and related materials (Commission, EU-Russian Trade Statistics, 2013)

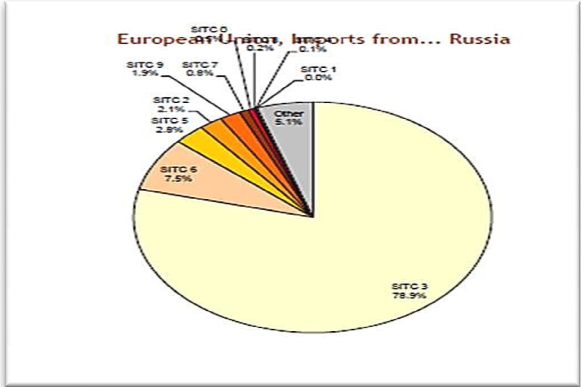


Figure 1: EU Imports from Russia 2011

This section explores the current engagement policies of the EU and Russia vis-à-vis one another with regard to energy interdependence. It will focus on defining the energy relationship

between the EU and Russia in terms of its security implications and determining whether or not the interdependence between the EU and Russia is acting to improve European security. While there are varying degrees of interdependence between individual EU members and Russia across a wide variety of commodities, the interdependency between the EU and Russia of energy supplies is of critical importance to the stability of Europe. Energy security plays an important role in the national security strategies and foreign policy objectives of both the EU and Russia. The first part of this paper provides a clearer understanding why the Russian government puts such a high priority on the stability of Russian energy export markets. While the income from Russian energy exports allows Russia to continue improving its status as a regional power, without the dependable income from energy exports Russia could experience another economic catastrophe.

Tom Casier developed a useful framework for discussing the energy relationship between the EU and Russia in terms of its security implications. In his article he explores four criteria to define this relationship: EU supply vulnerability, Russian demand dependence, Dominance of energy in EU-Russian relations and Willingness to use energy as a political instrument. (Casier, 2011) The first two criteria, EU Supply dependence and Russian demand dependence, provide a way to characterize the level of dependence that Russia and the EU share in energy imports. The more vulnerable that the EU is to supply interruptions of Russian energy imports, the more likely the EU is to seek alternative sources of supply. In realist terms this vulnerability is measured by weighing the costs to the EU to replace energy imports from Russia in the event of a long term interruption in supply. These costs would be measured not just by the higher costs of replacing Russian energy supplies directly, but must include broader economic losses throughout such a crisis due to supply shortages. Examining Russian demand dependence provides a measure of

how lost energy export revenues would impact Russia in the event of a long-term interruption of supply. To measure Russian demand dependence one would include not only the costs of building infrastructure such as pipelines to alternative customers such as China, but also the economic losses in the interim.

Examining these two criteria can help answer the question of whose national security would be more at risk if energy imports from Russian to Europe were interrupted. According to realist theory, the financial costs associated with an interruption of the energy trade between Russia and Europe is what would make one side or the other more likely to pursue a military solution to such a crisis. Common knowledge is that the EU is at serious risk because of its dependence on Russian energy imports. In reality, Russia is more at risk if this relationship were to be interrupted. The economic losses to Russia because of an interruption of energy exports between the two would be more acute for Russia because they would be felt immediately in loss of revenues. The impact to the EU would be more gradual, because the accumulated gas storage capacity of the EU and upgraded gas transportation infrastructure would allow the EU to continue supplying gas to EU consumers for 2-3 weeks. (Communities, 2009) Not only would the costs to Russia be more immediate, but because the income from energy exports funds such a large percentage of the federal budget they would also have a greater impact on stability.

To further define the term energy imports it is important to note the nature of which commodities are more susceptible to interruption. Crude oil demand to the EU has increased over the past decade, but the price of crude oil is regulated by the global market. While EU dependence on crude oil imports from Russia has increased by 10 percent from 40-50 percent over the past decade (Copeland, 1996), an interruption in crude oil imports from Russia to the

EU could be compensated for by increasing orders from other suppliers. Any interruption that would interfere with the crude oil supply from Russia to the EU would likely increase the global price of crude oil, but the EU would still be able to fulfill its import needs by increasing purchases from other global suppliers. Natural gas however is another story. “Natural gas, unlike oil which is a global commodity, is a regional commodity with regional buyers and sellers exerting more influence.” (Ratner, Belkin, Nichol, & Woehr, 2012, p. 1)

Natural gas delivered from Russia to the countries of the EU through the various pipelines are provided at significantly less cost than if the EU were to have to import natural gas from other sources. Liquefied Natural Gas (LNG) is very expensive to transport and store and would require costly infrastructure expansion. Additionally, LNG would primarily benefit coastal regions, with limited benefit to inland European countries. Any increase in the EU demand of LNG because of an interruption in supplies from Russia would require significant infrastructure upgrades at port facilities and would represent a significant cost. The increase in costs of natural gas associated with securing alternative supplies would likely be paid for by European consumers and would put a heavy burden on EU economies. (Ratner, Belkin, Nichol, & Woehr, 2012)

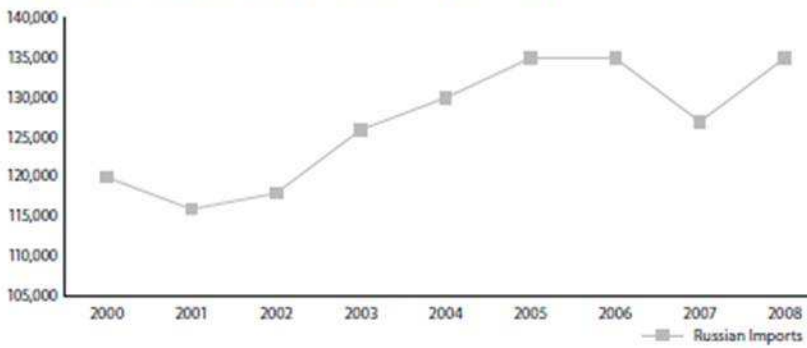
From the Russian point of view however, an interruption in revenues from crude oil and natural gas imports to the EU would be catastrophic. The only other efficient way for Russian crude and natural gas to reach other markets would require significant long-term investment to build pipelines to China and the rest of Asia. In the meantime the financial losses because of a drop in demand or a collapse in prices of Russian energy exports would be catastrophic to the Russian economy. A decrease in the price of a barrel of crude oil alone by \$1, for example,

represents an approximate loss of \$40 Billion per year to the Russian economy. (Casier, 2011)

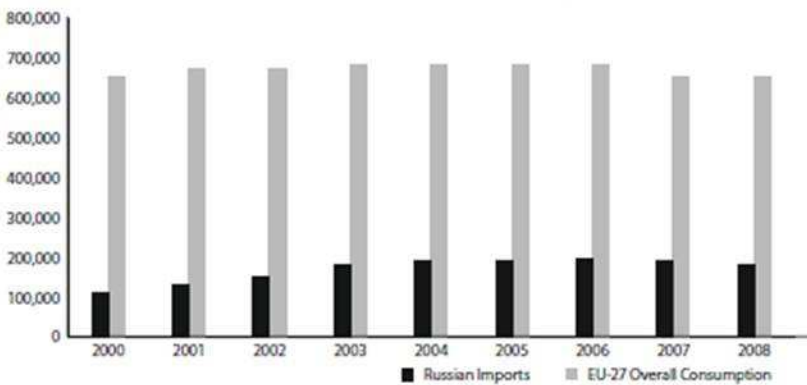
With the Russian federal budget being up to 80 percent reliant on gas and oil exports and the collapse of the Russian economy in 1999 so closely tied to the loss of revenue from energy exports we have a good idea of just how damaging such an incident could be in the future.

Not only is Russia reliant on the EU as a trading partner overall, but this reliance is also concentrated in one area – energy exports. Russian dependence on the EU market for its energy exports makes it unlikely that the Russia government would ever threaten the EU itself with disruption of natural gas and other energy imports. Recently, Russian President Vladimir Putin attempted to down play the reliance of the Russian government on income from the oil and gas industry. His claim that the Russian federal budget is only 50 percent dependent on oil and gas revenues conflicts with official Russian data that puts the figure at 60 percent. (Fin, 2012) Russia today puts the figure closer to 80 percent. (Pempel, 2012) Even if the conservative figure of “only” 50 percent provided by Putin was accurate, any threat of disruption of Russia’s oil and gas income would be considered a threat to the stability and thus security of Russia. The chart below, shows the EU imports from Russia of oil and natural gas from 2000 to 2008. While EU consumption of oil during this period has remained relatively stable, the amount of oil imported to the EU from Russia has generally increased. The natural gas imports to the EU from Russia have increased steadily (except for a drop in demand associated with the world economic crisis) and are projected to increase through 2030. (Casier, 2011)

Natural Gas: EU-27 imports from Russia between 2000–2008



Oil: EU-27 gross inland consumption and imports from Russia between 2000–2008



(Union, 2011, p. 63)

Although the EU plays an important role in establishing the framework for regulating gas supplies between its member states and Russia, the actual contracts between Russia and EU member states are primarily bilateral commercial agreements. Overall EU reliance on Russian gas supplies varies greatly between EU member states. One quarter of all energy consumed in the EU is gas and 58 percent of this gas is imported. Of this imported gas, 42 percent comes from Russia, and around 80 percent of EU imports of gas from Russia pass via Ukraine. As of 2011, Russian natural gas was delivered to Europe through 12 pipelines, of which three pipelines were direct pipelines (to Finland, Estonia and Latvia), four through Belarus (to Lithuania and Poland) and five through Ukraine (to Slovakia, Romania, Hungary and Poland). In 2011, an additional pipeline, Nordstream, began operating bringing gas directly to Germany through the Baltic Sea. The largest importers of Russian gas in the European Union are Germany and Italy, accounting

together for almost half of the EU gas imports from Russia. Other larger Russian gas importers (over 5 billion cubic meter per year) in the EU are France, Hungary, Czech Republic, Poland, Austria and Slovakia. (Communities, 2009, p. 2)

The variance of reliance on natural gas between EU members is great and has increased overall since the EU enlargement of 2004. Before the 2004 EU enlargement the average dependence of EU member states on Russia for its gas imports was around 25 percent. Among the new member states, however, the average dependence is around 74 percent. Among the old member states, Finland is the only country being fully dependent on Russian gas, while several other states do not import gas from Russia at all. Among the new member states, Estonia, Latvia, and Lithuania are fully dependent, while Bulgaria and Slovakia are highly dependent. Malta and Cyprus do not import gas from Russia. The average dependence of EU individual states on Russian gas rose from 25 percent before to 47 percent after the enlargement. (Communities, 2009) The average dependence of the fifteen old member states has not changed substantially. This suggests that the change in the EU's perception of its own energy security cannot be explained by a rise of overall energy dependence in real figures, but rather by an increase in the number of EU members who are dependent on Russian gas imports. (Casier, 2011, p. 542)

The Gas Crisis of 2009

An examination of the events surround the January 2009 gas supply interruption provides important insights into the EU's vulnerability to supply disruptions. This event also allows us to examine the impacts to the Russian economy of a gas supply disruption to Europe.

“The January 2009 gas disruptions resulted in the most serious gas supply crisis to hit the EU in its history, depriving EU Member States of 20 percent of their gas supplies (30 percent of imports). Coinciding with a cold spell in many parts of Europe, it demonstrated the vulnerability of the EU and some of its Member States to gas disruption”. (Communities, 2009, p. 7)

The EU gas supply crisis of January 2009 occurred essentially, because of an unresolved commercial dispute between Naftogaz of Ukraine and Gazprom of Russia. The crisis began in mid-December 2008 when Gazprom announced that it would interrupt gas supplies to Ukraine unless an agreement was reached over outstanding payments owed by Ukraine and Ukraine agreed to sign a new gas contract, increasing the price to market value. Until that time Ukraine (as well as many other former Soviet Republics) enjoyed the benefit of gas prices substantially lower than market value. With the dispute still unresolved on 1 January, Russia cut off supply of natural gas to the Ukraine. In response Ukraine refused to allow Russian natural gas to transit through the Ukraine to Europe and on 7 January 2009 all natural gas supplies to the EU through Ukraine were shut off. While there is a strong argument that this move was taken in response to political conflict between Russia and Ukraine, the actions of Gazprom were within its legal rights. So whether or not the decision was primarily commercial or primarily political would have little effect on the outcome. (Rutland, 2008) After intense negotiations gas supplies were restarted on 20 January and fully restored on 21 January.

From the EU perspective the disruption of gas supplies highlighted its vulnerability. Actions taken by the EU and individual member states between the 7th and 20th 2009 January would show just how unprepared they were to deal with such a crisis. The primary EU mechanism to deal with a gas supply disruption before 2009 was the assumption that each member would have a national response and that those responses would be sufficient. EU Gas Security of Supply

Directives in force since 2008 obligated each EU member to develop emergency measures to deal with gas supply interruptions. In practice however there was a large variance in levels of preparedness among members.

The primary strategy to compensate for supply interruptions in the short term was to access natural gas from storage. Other strategies included increasing purchases of LNG on the spot market and fuel switching. Diversification of both of suppliers and routes was also encouraged by the EU Gas Security of Supply Directives. Increasing shipments of LNG from North Africa provided alternative sources of supply to countries with sufficiently developed LNG port landing facilities such as Greece. Likewise, purchases of Russian gas delivered through pipelines in Turkey and Belarus was increased. However, primarily due to a lack of a regional strategy and cooperation between members, these strategies were not sufficient to prevent complete stoppage of natural gas supplies to large industry in countries like Bulgaria, Romania, Hungary and Poland in order to meet home heating demands.

EU Responses to Energy Insecurity

The overarching theme that came out of the EU analysis of the 2009 crisis was unity. From political solidarity to increasing financing for the construction of gas infrastructure interconnectivity between EU members, all agreed that while energy security is a national issue, a comprehensive solution could only be achieved at the EU level. Lost revenue to Gazprom for the 13 days of unsupplied gas (7-20 January) to the EU were estimated at \$1.1 billion and over \$2 billion for the entire period from 1 to 20 January. But more importantly was the serious damage to consumer confidence in both Russian and Ukrainian as reliable partners in the gas supply chain. (Communities, 2009, p. 15) Even if there is never another preventable gas

interruption, an interruption due to an accident, natural disaster or an act of terrorism could have a serious effect on European supplies. This has encouraged the EU to pursue a broad range of actions to improve the interconnectivity of the EU energy market. According to Gunther Oettinger, EU Commissioner for energy “in the 2009 gas crisis there was enough gas on the European market, but because of lack of interconnections it could not flow to the places where the demand was highest” (Commission, Security of Energy Supply in Europe, 2011, p. 8)

Russian Risk

The actions being taken by the EU to improve the security of its energy supply will have a profound effect on Russian demand security. Decreases in demand because of the 2008 financial crisis and EU actions to diversify its gas supply have had an impact on Russia’s gas industry. If Russia continues to rely so heavily on the energy sector to fund the government they will have to invest in opening alternative markets for their energy exports. Meanwhile as the EU moves forward with plans to diversify its energy supplies and develop an interconnected energy market, Russian demand security grows increasingly more unreliable. The easier the EU can withstand supply interruptions the less likely they are to accommodate Russian demands. Ultimately, this undermines Russia’s primary geopolitical strength as the major energy supplier to Europe and puts Russia back in an insecure position.

Russia, recognizing this, is going to great lengths to integrate itself along the full spectrum of the energy supply chain in Europe by purchasing interests in energy transmission infrastructure throughout Europe. By threatening to expand its energy consumer base to Asia by constructing pipelines to China and India only serve to hasten the European move to secure its energy supply.

The Principled Engagement Strategy

Under this strategy EU members are encouraged to enter bi-lateral agreements with Russia only if those agreements support overall EU goals. The primary goal of the principled engagement strategy is to balance Russian dependence on EU imports with security of the EU's energy supplies and to improve the future trade expectations in both the EU and Russia. This strategy is characterized by strict adherence to EU (and other global governing bodies') anti-corruption laws and developing solutions to counter Russian manipulation of energy and other markets. This strategy could help to reinforce and balance the interdependencies between Russia and the EU required to secure economic and political interest of both.

This is the strategy that the EU has endorsed in the treaty of Lisbon, which came into effect in 2009, as well as several other legislative measures previously discussed to attempt to motivate individual EU members to align their national bilateral relations with overall EU goals. While previous attempts to unite EU members in support the overall energy policy of the EU over their own national interests were unsuccessful, the Ukrainian gas crisis of 2009 created a new impetus to move forward and put into practice the measures already agreed to in principle under previous EU policies. The EU's Third Energy Package was proposed in September 2007 with the ambitious goal of liberalizing EU energy gas and electricity markets, creating greater competition in the EU. However, it was not until EU members experienced firsthand the consequences of a serious disruption to the gas import supply that enough EU members would support those measures. One key component of the EU's third energy package is ownership unbundling, which separates power generation and sales operations from the transmission networks. The other key component was to accelerate the investments in infrastructure needed to

improve EU cross border trade. Having finally experienced the insecurity of a serious disruption of gas imports, more EU members now view the costs required to improve gas and electricity infrastructure as more of a necessity than they previously did. The EU's third energy package was adopted just six months after gas supplies were restored following the 2009 crisis and came into force in September 2009. (Vaïsse & Kundnani, 2012, p. 26) Perhaps this is the reason that so much has been made of the gas supply crisis of 2009. Nothing can develop a sense of unity between different groups of people as a shared crisis.

Conclusion

Stable interdependencies, with expectations that that they will remain so in the future, can improve national security. When both trading partners have confidence that critical interdependencies such as energy supply and demand are secure then the costs of interrupting economic trade outweighs the benefits of making other compromises. In the case of the energy interdependency between Russia and the European Union this balance is particularly sensitive. With the Russian economy so heavily dependent on maintaining the price and demand for energy exports to Europe, Russia has much to gain by proving themselves a reliable trading partner. The shock of the 2009 gas crisis, Russia's reliability as a dependable energy supplier has been questioned. Now with the expectations of reliability of energy supplies in question both Russia and the EU must carefully manage the relationship to ensure that both European supplies are stable and the demand for Russian energy exports are balanced to prevent a catastrophic loss for either side.

Since the world economic crisis of 2008 energy demand has decreased overall and losses to the Russian economy have already had an impact. With demand decreasing in the short term and Russia's position as a reliable partner in question, the Russian government should be doing everything in its power to reassure Europe that they are willing to make the necessary adjustments to ensure stability in the energy market. Recent concerns over the financial stability of Gazprom have the potential to cause an acceleration of EU plans to diversify their energy supplies. (Cardais, 2013) There is a window of opportunity for Russia to either reassure the EU that they are willing to accept marginal short term losses in adapting their energy trading policy to new realities in the EU, or that Russia will significantly expand its energy export market by making the infrastructure investments to access the Asian marketplace. Since Russia is now a member of the World Trade Organization (WTO) Russian political elites have little choice but adhere to the multilateral commitments required of a WTO member. If Russia plans to expand the foreign market for its energy exports we should already be seeing new contracts with Asian countries such as China and the beginning of construction projects building new liquefied natural gas (LNG) terminals and or pipelines to carry Russian oil and gas to Asia. Until Russia takes substantive steps to secure its energy export market with non-EU customers, political leaders are signaling that they still expect to profit from future trade with the EU and that Russia will continue to rely on energy exports to the EU market for the short to medium term.

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