

RUSSIA-EU RELATIONS: AN EMERGING ENERGY SECURITY DILEMMA

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Introduction:

The European Union (EU) predicts a significant increase in the amount of energy it will have to import: imports which currently account for approximately 50% of its energy consumption, are expected to rise to some 70% in 2030, in the case of oil products to 90%.² This has raised the profile of the EU's relations with Russia, one of the EU's neighbours, and one of the world's key producers of oil and gas: its discovered and projected oil and gas reserves are among the largest on earth. Western Siberia is the world's richest hydrocarbon province, and there are high expectations of potentially enormous reserves in other regions which have yet to be exploited or even fully explored, such as East Siberia, the Komi Republic, Nenets Autonomous Okrug and the Barents region

Russia's reserves also contribute the EU's energy security by enhancing the diversity of its supplies. In tune with Winston Churchill's oft-cited dictum that "safety and certainty in oil lie in variety"), Russia is considered important as an alternative source to potentially unstable Middle Eastern suppliers.³ This benefit of having Russia as an alternative is further supported by Russia's strong record as a reliable supplier to the EU, even during the Cold War.

And a reciprocal relationship has indeed developed, whereby the EU-25 today imports 50% of its gas from Russia and 30% of its oil. More than 50% of Russia's energy exports go to EU, which has provided a large share of Russian income. This mutual relationship, particularly in terms of gas, is expected to grow.

Yet there are growing concerns in many quarters in the EU about any increase in the EU's reliance on Russian hydrocarbons. This is partly because the broader EU-Russia relationship has been problematic of late. Particular disagreements have arisen over visa requirements for transit for Russian citizens between Russia and the exclave region of Kaliningrad (2003-4) and over the elections in Ukraine (2004-5), in which Brussels and Moscow espoused opposite causes. Moreover, regular EU criticism of the brutality of Russia's counter terrorist methods in Chechnya and widespread criticism in several EU member states of the increasingly authoritarian trappings of President Putin's leadership, have undermined relations. As one commentator noted recently, critics of Russia in Brussels (and Washington) seem to talk of Russia as a "borderline outlaw nation" – and the build up to the G8 summit as the "biggest rethink of Russia's relationship with the West since the collapse of the Soviet Union."⁴

Linked to this, there are anxieties about Russia's future reliability as a supplier and the consequent potential threat to EU interests that Russia might pose if the EU was dependent on Russian hydrocarbons. This has been emphasised twice recently: first in October 2005 at the EU-Russia summit in London, where concerns were voiced by many about the EU's dependence on Russian oil; then in early 2006, when gas supplies in a number of EU member states were affected by the dispute between Russia and Ukraine during which Gazprom turned off supplies to Ukraine; and lately

at the EU-Russia summit in May in Sochi, when EU representatives noted concerns about Russian energy exports to China having an impact on exports to the EU.

In addressing the complex nature of EU-Russia energy relations, this paper looks first at the EU-Russia energy dialogue. It then turns to examine three central interlocking questions that lie at the heart of EU-Russia energy relations. First, it assesses the political side of the relationship, particularly concerns about Russia's political reliability as a supplier. Second, it examines the practical side of the relationship, focusing on Russia's resources and ability to meet the EU's needs. Finally, it looks at the EU-Russia relationship in the wider international context. Two key themes emerge: the danger of increasing mutual distrust leading both sides to diversify away from each other (the EU to new sources, Russia to new markets) to enhance their energy security; and that of Russia not being able to meet EU needs in the medium-to-long term.

The EU-Russia Energy Dialogue:

The EU-Russia energy dialogue was launched on the initiative of Presidents Chirac and Putin and the then-Commissioner Prodi, in the recognition that Russia and the EU are natural partners with mutual interests in the energy sector and continental energy security. The objective was to provide a forum for the discussion of all questions of common interest in the energy sector and bind Russia and the EU into a closer relationship. Working groups have met regularly to address energy strategies, technology transfers, investments and energy efficiency. A Technology Centre was established in November 2002 for the exchange of information and the promotion of new energy technology to support Russia in accelerating the development of the oil and gas sectors.

The UK presidency of the EU Council during the second half of 2005 sought to prioritise the energy dialogue and add new dynamism to it. Plans and aims were agreed and a framework for the achievement these plans established at a Permanent Partnership Council (PPC) meeting, held on 3rd October 2005. This imbued the dialogue with more structure, broadening it to include a wider set of interlocutors with vested interests, including business and political authorities from both Russia and the EU. These are represented in four thematic groups, focusing on investment, infrastructure, trade and energy efficiency.⁵ The energy dialogue is also high among Austria's priorities during its Council presidency, and was a key element of bilateral talks between European Commission President Barroso and President Putin. In preparation for the meeting on 17 March 2006, Barroso stated that he sought to place a "new" energy partnership "at the heart of our relations."⁶ Another energy PPC is planned for the Finnish presidency later in 2006.⁷

Officially, the dialogue is considered to have produced positive results acting as a problem solving forum and opening the way to European investment in the Russian energy market.⁸ The EU repeatedly stresses strong *common* interests in the energy sector. Repeatedly, the EU stresses Russia's proven reliability as a supplier, respecting as it has the dates, amounts and prices agreed even during periods of domestic or international turbulence. According to EU officials, there have been no signs from Russian executive officials about Russia using its energy resources as a diplomatic lever against the EU.⁹

Yet if it provides a good forum for discussion, positive practical measures remain marginal and the dialogue has been held up by differing interpretations and priorities. Russia seeks support to modernise its energy sector and protect itself, while the EU wants reform and the opening of the Russian market through the creation of a positive business climate.¹⁰ Such differences were most recently noted by Martin Bartenstein, President of the EU Energy Council. Although he advocated a “new-style energy partnership” between the EU and Russia, since both partners were “mutually dependent,” he also stated that it is important in this connection for foreign investors to have access to Russia, just as Russia’s Gazprom has access to Europe’s capital and energy markets. Indeed, Bartenstein also noted other difficulties, including Russia’s energy inefficiency and lack of agreement on the Energy Charter Treaty.¹¹ He seeks the ratification of the Energy Charter as soon as possible, “ideally before the summer,” but noted that the Russian side has been “very reserved” in its response while simultaneously pressing for treaty negotiations with the EU on a transit protocol to guarantee the freedom of energy transit through existing grids.¹² Others on the EU sides argue that, particularly in terms of the environmental aspects of the energy relationship, the two sides speak different languages: simply, too many in Russia do not believe the science of climate change. There is also a less environmentally-friendly approach to infrastructure development, illustrated by the debate over the Lake Baikal pipeline. Originally planned to run along the shore of the lake, it was considered legal and Transneft claimed wouldn’t damage the environment. Although Rostekhnadzor, the Russian environmental watchdog reversed its original opposition to the pipeline, environmental groups have strongly opposed the construction, since it is in an earth quake zone – there was a strong risk of an oil spill. Indeed opposition has been such that President Putin has ordered it to be re-routed, despite Rostekhnadzor’s recommendation.¹³

Political Problems in the EU-Russia Energy Relationship:

Outside the specific energy dialogue the relationship is beset by a lack of confidence on both sides. Indeed, diversification, one of the key tenets of energy security, may begin to undermine the EU-Russia relationship, as both seek to diversify away from each other in an effort to enhance their energy security.

On the EU side, two main problems lie behind the calls for greater diversification of hydrocarbon supplies, particularly away from Russia. First, some have argued that the EU’s dependency on Russian energy undermines its ability to negotiate with, and particularly to criticise, Russia. The argument runs that whatever reservations they may have about political developments in today’s Russia, the Europeans have a “strong incentive to be tactful” because of its energy dependence on it.¹⁴

However, even amid the heightened concerns of the last few months, it does not seem that energy dependence is affecting the EU’s ability to raise uncomfortable questions with Russia: Chechnya was discussed at some length during the summit in London. In fact, if the EU continues to dominate Russian oil and gas export quotas – or increases them – it will be in a stronger position to apply more effective sanctions or boycotts against Russia in any major disagreement.

Second, unease has been voiced in many quarters that the EU could find itself increasingly at the mercy of an ever more authoritarian Russia which might use its control over a large share of the EU's energy imports as a diplomatic lever by threatening to turn off the taps to blackmail it. Such anxieties have been aggravated by the comments of some prominent Russians about Russia's rise as an energy superpower and the benefits accruing to Russian foreign policy by dominating the energy sector.¹⁵ Comparisons are often made between the influence derived from Russia's energy reserves and the influence derived from the nuclear weaponry of the USSR.

Such concerns are usually illustrated by evidence drawn from Russia's relationships with the Newly Independent States (NIS), in which Russia is considered to have systematically directed energy cut-offs to pressurise and limit their political and economic autonomy and alter their western orientations. Thus according to one analyst, "current Russian policies pose a threat to the development of transparent democratic governments and free market policies in those countries that depend on Russia for their energy resources."¹⁶

Cut-offs to the NIS, particularly to Belarus (2004) and Ukraine (2006), have had a significant knock-on impact on EU member state reserves, particularly on those in Eastern and Central Europe – as illustrated in January. Indeed, cut-offs by Russia to the NIS for failure to pay may well increase in frequency, since Russia is again raising prices – in 2007, Russian gas delivery prices to Belarus will be increased to European levels. This might mean a two-to-five fold price increase, depending on Gazprom's acquisition of Beltransgas, the Belarusian company that exports Russian gas to Western Europe.¹⁷ Nonetheless, there are several points that should be made in this regard. Although many immediately placed all the blame with Russia (and there should indeed have been greater communication between Russia and the EU), Ukraine also bears considerable blame.¹⁸ The crisis therefore illustrated not so much Russia's political unreliability regarding supplies to the EU, but that energy security is not simply an "unreliable producer vs. vulnerable consumer" dialogue,¹⁹ as often portrayed, and more of a complex producer-consumer-transit state triangle.

Moreover, aside from the highly questionable nature of some of the (often unsubstantiated) accusations being levelled at Russia, energy is a blunt weapon that is difficult to target, often ineffective, and usually one which rebounds to harm the wielder as much, if not more than the target. Finally, it is a great leap to compare the NIS and the EU: the context is wholly different. The EU is a very different actor, being much wealthier and more able to diversify its supplies (indeed, Russia is already a diversification for the EU in terms of oil): the "dependency" argument is less applicable. Yet these more sober arguments have hardly featured in what has for the most part been a knee-jerk reaction in EU member states, one which, despite the redrafting of the EU's Energy Security Green Paper, has generally been too quick to worry about the political threat posed by Russia and too slow to ask serious and reflective questions.

In fact, official accounts and expert analysis suggest that Russia has more concerns about the future of the relationship than the EU. If the development of the EU's internal market creates opportunities for Russia by building the world's largest and most integrated energy market on its borders, it also creates problems, particularly

about access to this market and EU limitations on the quantities of energy imports from Russia.²⁰ Russian analysts argue that the European Commission will show “maximum tenacity and assume a hard stance” in safeguarding EU interests. Without proper consensus defining exactly what Russia’s interests and priorities in the energy sector as a whole are, Russia’s negotiating position in face of this tenacity will be weakened. Yet such real and lasting consensus will be difficult to achieve and many questions remain – what should be the goal of Russia’s energy policy in Europe? What limitations and risks are involved? How can export revenues be best used for Russia’s development?²¹

This point is emphasised by those who argue that the objective of the energy relationship is to pressure Russia to initiate energy sector reform, particularly regarding aligning its domestic prices with those of the world market. The Russian side has argued that it would be politically unrealistic to raise prices sharply to poor domestic consumers and also difficult for Russian enterprises to be competitive should prices be so raised (many Russian industries remain highly inefficient and rely on cheap energy to subsidise their operations).

Finally, if European gas demand is rising, oil consumption is not. EU gasolines consumption fell from 3.8 million barrels per day (mbpd) in 1994 to 3.5 and fuel oil from 1.95mpbd to 1.65 in 2004.²² Overall growth (just 0.7% 2003-4) is not just slow but fluctuating – slow but steady growth from 1994 to 1998 almost stopped in 1999, before decreasing in 2000. Renewed growth in 2001 was again followed by a decrease in 2002. 2004’s consumption was approximately that of 2001.²³ Even if “domestic” EU oil production is falling, increasing the need for imports, insipid growth in Russia’s key market cannot but cause concern in a state that relies heavily on such exports to sustain its economic growth and development.²⁴

Furthermore, if Russia is an important supplier of oil to Europe, it is also a marginal one, and Europe’s “dependence” on Russian oil is questionable.²⁵ Even analysts who highlight the EU’s vulnerability to Russian machinations note that in 1999, the EU imported 16% of its oil from Russia, but that this had dropped to circa 15-14%. Europe “receives the lion’s share of Russian oil exports and Russia’s importance will only grow further,” the authors argue. However, if the EU’s share of Russian exports has doubled since 1991 (“receiving the lion’s share” of Russian oil exports), while Russia’s share of the EU’s total oil import *decreases*, this suggests that *Russia is more dependent on the EU market than the EU on Russian oil.*²⁶

Additionally, although the EU imports a higher percentage of its gas needs from Russia, revenues from European exports effectively maintains the Russian gas industry. Raising the prices of exports to the newly independent states will make these markets more profitable, but one expert has argued that only if Russian earnings from European gas imports fall to a very low percentage will it be time to question whether Russia “can afford to jeopardize security of gas supplies to Europe.”²⁷

The relationship is therefore clearly mutually beneficial. EU member states need Russian energy to sustain their economies, Russia needs the EU market to sustain its growth. And the existing infrastructure further ties the two together: the main pipelines flow west to Europe. Here lies a potentially very serious problem. If both sides become nervous about their energy security, diversification away from

each other may appear to be the answer. As noted above such discussions are taking place in the EU. According to one analyst, there are fears in Russia that the EU will seek to exert pressure on Moscow on one hand and seek other sources before Russia can develop other markets. These fears result in the stoking of fears of retaliation if alternative deals are pursued by the EU.²⁸ Thus an energy version of the security dilemma is emerging – when one state, suspicious of military preparations by another, begins to make its own preparations in case the other intends to threaten it. In response, the former itself becomes increasingly suspicious, and prepares in turn for the inverse eventuality, beginning an arms race and an unstable relationship.

It seems that this is in fact happening, and confidence on both sides, already low, seems to be dipping further. Again, there is a somewhat conflicting image here from both sides. As noted above, senior EU officials have attempted to highlight the interdependent nature of the relationship. And senior Russian officials have done the same: Finance Minister Alexei Kudrin has argued for more pipelines to be built to Europe to ensure supply, predominantly against disruption to supply caused by third parties.²⁹

However, there have also been very high-profile warnings from both sides, and it seems that both sides are now intent on telling the other that they will diversify away from each other. Semyon Vainshtok has stated that Russia had “overfed Europe with crude” and repeated his suggestion that Russia should diversify its oil flows by building pipeline capacity to the Far East. This would, he argued, “immediately take away crude from our European colleagues” – although he also noted that Russia could not yet reduce its supplies to Europe.³⁰ These comments came hard on the heels of similar ones by Alexei Miller, Gazprom CEO at a meeting with EU ambassadors on 20 April. He stated that if the EU does not allow Gazprom to directly own distribution and retail natural gas infrastructure they would face retaliation that could include a diversion of Gazprom’s gas to other markets, particularly the USA or China. (Equally, it should also be noted that Miller has said that Gazprom “understood” its responsibility and “henceforth will remain the guarantor of energy security for the European customers.” He also added that Gazprom was able to satisfy reliably growing gas demand in Europe, and Gazprom would “faithfully fulfil all gas contracts with European clients.”) Nonetheless, this appeared to be a reaction to talk in Brussels about applying EU anti-monopoly regulations to it and to reports of the UK government considering changes to its merger rules to prevent Gazprom taking over Centrica, the UK’s major gas supplier. Gazprom does not yet supply the UK, but has noted its intention of entering the UK market – it has said that it aims to supply up to 20% of the UK’s gas by 2015.³¹

Some suggest that this statement, considered by many to be a veiled threat, surprised the EU’s ambassadors. Perhaps, but these statements follow on from those made in March about the EU’s double standards in energy security and rejecting its criticism of Gazprom’s actions towards Ukraine in January as “Cold War rhetoric.” Alexandr Medvedev, Head of Gazexport, Gazprom’s export business, was also dismissive of the Energy Charter Treaty and the signatory nation’s failure to uphold the “rule that transit should not be mixed with supply.”³²

Moscow’s position stiffened further since the May 2006 EU-Russia summit, illustrated by Alexei Miller’s announcement at the International Gas Congress in

Amsterdam and the submission of a bill on gas exports to the State Duma. In this respect, one further factor should be noted – the deepening ties between Gazprom and Sonatrach, the Algerian gas giant, and the possibility of the creation of a gas cartel. Although no document was signed in March, the discussions were reported in the Algerian press as the first step towards the creation of a powerful energy lobby that would force Europe to bend.³³

The EU has rejected these statements and more assertive position, in turn warning Gazprom both to stick to its contractual commitments and against threatening EU energy supplies.³⁴ Moreover, there are reasons why Gazprom will not carry out threats, which are noted below – but these particularly include a lack of infrastructure to carry this out and also the inherent problems of increasing infrastructure to China when there are concerns about the Russo-China relationship.

This has, however, stimulated – once again – calls in the EU for diversity away from Russia. The spokesman for EU Energy Commissioner Andris Piebalgs, Ferran Tarradellas Espuny, stated that “Gazprom’s statement gives grounds to our concerns on the growing foreign dependency of European energy supply and ... our need to diversify both the origin of our supplies and our supply routes.” Fatih Birol, the IEA Chief Economist has also warned the EU about becoming too dependent on Russian energy supplies, particularly gas.³⁵

Russia’s Hydrocarbon Resources & Their Sustainability:

Russia’s discovered and projected reserves are considered to be among the largest on earth, Russian gas reserves are calculated to be approximately 47 trillion cubic metres; a quarter of the world’s total; estimates suggest oil reserves in excess of 100bn barrels.³⁶ High expectations about Russia’s capabilities as an energy producer have been further raised by a major increase in production and export since the late 1990s, particularly in oil (the export of which reached a new post-Soviet high of 9.53mbpd in 2005).³⁷

Russia may not, however, have the ability to convert its potential into the long-term endurance hoped for by consumers. Official Russian estimates for production are considerably more conservative than those of the International Energy Agency (IEA). The IEA projects that Russian production will be approximately 10.4mbpd in 2010 and 10.7 in 2020 – the Russian Energy Strategy projects 8.9-9.8mbpd in 2010 and 9.0-10.4 in 2020. For gas, the IEA projects that Russian production will be 655 billion cubic metres (bcm) in 2010 and 801 in 2020. Again, the Russian projection is lower, however: at 555-665bcm in 2010 and 680-730bcm in 2020.³⁸

In fact, Russia’s ability to continue to produce and export gas is a source of concern. A mounting dependence on a small number of very large fields which are considered moderately to very mature (in 2002, 80% of Russia’s gas was being produced at mature fields with declining production) does not necessarily mean that shortages are immediate. Experts note that these reserves have not been fully exploited, with oil remaining in the flanks of fields or at deeper levels than those currently being developed and that levels of production can therefore be maintained for several years based on fields presently operating.³⁹ Nonetheless, it does mean that

the energy sector is fragile and vulnerable to accident. A field accident which shut down 50% of the production of one large field could have an impact on national production.⁴⁰

Given this dependence on a few large mature fields, some predict the quick depletion of Russian oil and gas reserves. Gennadi Shmal stated that Russia's energy exports are in danger: "Unless the government and public stop thinking about oil and gas as some magic wand that works and works and doesn't ask to eat, soon Russia will lose its export capacities." The only solution, he argued, is to establish a wide programme of geological exploration and tapping of new deposits.⁴¹ Yuri Trutnev, Minister of Natural Resources, also declared that exploration is urgently needed to prevent a levelling off or even fall in Western Siberian output after 2010.⁴²

The new fields which are important sources of growth are some way from coming online. Although the development of new gas fields in Eastern Siberia, the Far East and the Arctic North are expected to become a priority, this is depends on the ability of the main producers to raise the required investment. One estimate given by the Russian Deputy Minister of Natural Resources, Pyotr Sadovnik, was of \$65 billion to explore and put into operation gas and oil fields in North West Russia alone through 2020, of which \$5bn would be spent in exploration, approximately \$50bn in operation and \$10bn in pipelines.⁴³ The IEA estimates that to maintain and develop Russia's energy infrastructure, the investment of just under \$1 trillion is necessary to until 2030.⁴⁴

This is not just because in many case these fields have to be developed from scratch, including exploration, the building of infrastructure and production. Geographic constraints significantly raise these costs: many of the Russian reservoirs to be explored and exploited are in very harsh climates, thousands of miles from the nearest markets (where there is no infrastructure). One estimate suggests that these factors raise the cost of production dramatically compared to other producers: a barrel costs on average \$1-1.5 in the Middle East to produce, but as much as \$12-14 in Russia. Russia also then has to pay extra to transport the resources to its markets.⁴⁵ Simply, some of the more distant new fields are not very attractive business propositions, and so some Russian reserves will remain beyond the reach of technology for the foreseeable future, and more will be viable only in an environment of sustained high oil prices.⁴⁶

The political and business atmosphere in Russia, however, is ambiguous, undermining confidence in the investment climate: it is not the availability of cash so much as the confidence to invest it that is the problem. Questions remain about tax, guarantees on private property and ownership and licensing laws making the huge capital outlays which are necessary unattractive in such an atmosphere – as one commentator has phrased it, investment requires a "new appetite for risk."⁴⁷

Moreover, in many areas, transit capacity is either insufficient or non-existent.⁴⁸ Many of the gas pipelines are entering the later stages of their planned lifespan and in need of upgrading or constant repair. Furthermore, bottlenecks in the port and pipeline system mean that export capacity is incapable of meeting the ambitions of producers. The US Department of Energy estimates that of the 7mbpd for export, only 4 are exported by trunk pipeline, the rest is transported by rail and

barge. Thus, unless there is significant investment to expand the pipeline infrastructure, only non-pipeline exports will be able to grow in the near future. This poses concerns for Russia, however, as export is vulnerable to the vagaries of oil prices. Should they fall, rail and river transport becomes uneconomic. Yet, as noted above, currently only rail routes supply East Asia. However, clashes between private companies and state monopolies over the construction of pipelines have undermined the potential to modernise the network. A consortium of Russian private companies including LUKoil Sibneft, TNK and Yukos sought to build a direct pipeline from Western Siberia to Murmansk to export oil to the US market. This however encountered serious opposition from Transneft, putting the pipeline in doubt.⁴⁹

Finally, questions remain about the structure of the energy sector in Russia. The most prominent of these focus on whether the big companies are the most efficient vehicles for the exploitation of resources and maximisation of shareholder wealth and whether the industry's narrow and concentrated nature around a few big giant companies obstructs long-term maximisation of supply. Big companies will not produce smaller fields and smaller reservoirs in larger fields and may leave them fallow. The second tier of smaller companies which would have exploited them is shrinking as it is being bought up by the big companies. According to one expert, this means that "low-cost and more sustainable ... augmentation of supply is forsaken"⁵⁰

The second inefficiency lies in the centralised nature of the gas sector, which remains the least marketised and competitive sector of the Russian economy.⁵¹ There are only five companies (apart from Gazprom) with the ability to substantially increase gas production for sale to markets west of Siberia (BP-TNK, LUKOil, Rosneft, Surgutneftegaz and Novatek). However, the giant Gazprom still dominates access to the market, accounting for some 86% of production and sales. Gazprom's dominance and political weight (companies face hostile takeover attempts by Gazprom supported by the state) limits the export capacity, and thus ability to act independently, of these other companies.⁵² How the companies are managed, whether sufficient investments are made to meet the needs of development and their level of transparency are also crucial questions.

Simply, therefore, Russia has huge reserves of oil and gas, but if Moscow promotes greater production and exports to feed its budget, "technical, economic and political constraints bound this."⁵³ There is a danger of either a lag-time gap between the exhaustion of proved reserves and another growth period, or a more persistent decline. More probable, given the geography and costs, is decelerating growth, followed by a plateau which can be held for a number of years, followed by a slow decline in production levels.⁵⁴

The Wider International Context:

The international context highlights the preceding points. Given the relatively tense political situation between Russia and the EU, and given the finite nature of Russian resources, there will be increasing competition for those resources as Russia seeks to diversify its markets. This is particularly so given the increase in demand in other consumers, particularly in China, India, Japan and the USA which have all been negotiating deals with Moscow to increase their access of Russian oil.⁵⁵ The Chinese were rumoured to have financed Rosneft's purchase of Yuganskneftegaz, and China

reportedly paid a \$6.6bn loan for the long-term pre-purchase of oil.⁵⁶ This has led to the drawing up of plans for pipeline construction to the Pacific. LUKOIL began exporting oil to China in November-December 2004. Thus, according to Khristenko, export of Russian fuels to Asia and Pacific countries may rise six-fold by 2015.⁵⁷ Greater competition for Russia's resources is also likely to come from the USA, by a considerable margin the largest consumer on the world market, which has also begun to look to Russia as part of its energy strategy. A formal relationship has developed between Russia and the USA at the state level with meetings of special working groups and at company level.

None of these relationships, (particularly the Russia-US relationship) have developed yet. Nonetheless, such advances suit Moscow, as it seeks to maximise exports on the one hand and diversify its markets to enhance export security.⁵⁸ Some Russian experts have already noted that such plans have given rise to EU jealousy, with senior EU officials voicing their displeasure with Russian intentions to export energy eastward and to the USA.⁵⁹ Competition for Russian oil is likely to drive up prices and pose problems for slower growing economies, especially should Western Siberian oil be tapped to feed the Eastern pipeline while Eastern Siberian deposits are being explored and developed.⁶⁰

Conclusions:

The EU-Russia energy relationship highlights the key questions of international energy security today. First, it emphasises the political dimension – particularly the tense relationship between producers, consumers and transit states. Image plays an important role, and Gazprom's actions in January dented Russia's international image as a reliable supplier. Indeed, it created a crisis of confidence on the EU side, and as a consequence, a number of EU member states are planning to redesign their energy security strategies, with specific stated intentions to diversify away from dependence on Russia. This is beginning to have a knock-on effect on Russian confidence, which needs a secure market just as the EU needs a secure source. This must be carefully thought through, though by both parties – to which states or regions should the EU diversify away from Russia? Iran? Nigeria? Which markets would benefit Russia more? Would significantly increasing China's share in the market meet Russian strategic political and economic aims?

Second, it clearly illustrates the debate between peak and optimist camps. Russia's resources are considered vast. However, they are finite: if resource exhaustion is not imminent, there is a clear danger that without a coherent strategy for development, including clear and effective frameworks for investment in exploration, production and transit, Russian hydrocarbon resources will plateau and begin to decrease sooner than anticipated, with negative consequences for both producer and consumer alike, whether they be in Russia or the EU.

The energy sector is central to the future economic security and development of both Russia and the EU, and is a central element of the EU-Russia relationship. It is a dimension that is of real importance, rather than concocted political desire. It would severely undermine the energy security of both the EU and Russia if the relationship began to drift apart in the search for more superficially reliable sources. Concerns about Russia's reliability cannot be dismissed out of hand. But problems must be

more accurately pin-pointed. It is of real importance that the language moves away from notions of “dependence” on the other and producer vs. consumer: the relationship is a mutual one, with benefits as well as down-sides for both. Continued effort must be made by both sides to establish and develop the dialogue and confidence building measures and also the economics and technicalities of the relationship and broaden the range of those with a vested interest – both business and state – to enhance its progress.

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² *Energy: Let Us Overcome Our Dependence*, European Commission Green Paper, 2002. Luxembourg: Office for Official Publications of the European Communities, 2002. pp.2-3,9.

³ *The Energy Dialogue Between the European Union and the Russian Federation between 2000 and 2004*, Communication From the Commission to the Council and the European Parliament. Brussels, COM (2004) 777 Final, 13/12/2004. p.2.

⁴ Owen Matthews, ‘Reversal of Fortune’, *Newsweek*, 10/17 April, 2006.

⁵ Joint EU Presidency and European Commission Press release on the EU – Russia Permanent Partnership Council on Energy, 3rd October 2005, London.

http://www.europa.eu.int/comm/external_relations/russia/summit_10_05/ip05_1218.htm.

⁶ Following the Sochi Summit, Barroso noted that “we have made good progress in some areas” (referring to the agreement on and signing of visa legislation). Although he characterised the discussions as “open and constructive”, he also underscored the range of serious issues in the relationship, including the Ukraine gas predicament and the possible future gap between supply and demand, and strongly emphasised the mutual dependence between supplier and consumer. For his part, Putin also took a rather strong position, noting that if the EU wanted access to Russian resources, Russia sought equally responsive steps from the EU.

http://top.rbc.ru/news/policy/2006/05/25/25195429_pv.shtml;

<http://news.bbc.co.uk/2/hi/europe/5014774.stm>

⁷ “President Barroso to meet Russian President Vladimir Putin to “step up” EU-Russia strategic partnership”, IP/06/291 Brussels, 9 March 2006. www.europa.eu.int

⁸ See presentations by Jeffery Piper and Konstantin Trofimov in March 2006. EU-Russia: energy Security and Geopolitics, 17/03/06, www.theepc.be ; www.technologycentre.org ; Communication from the Commission to the Council, 13/12/04 on Energy Dialogue; EU-Russia Energy Dialogue, 6th Progress Report, October 2005 .

⁹ Russia-EU Energy Dialogue Synthesis Report No.1, September 2001; Summit Press Release, 04/10/05.

¹⁰ Lynch, D. *Russia Faces Europe*, Chaillot Paper No.60. Paris: ISS, 2003, p.65.

¹¹ The Energy Charter Treaty of 1994 came in to force in April 1998 and seeks to promote international cooperation in energy sector, acting as a legal basis to create an open international energy market. Full implementation of it increasingly focuses on cooperation on transit (the Transit Protocol), energy efficiency, environmental protection, investment and trade. Although Russia has signed the Charter Treaty – and although officials claim that Russia is implementing many of its commitments – it has not ratified it. See www.encharter.org

¹² “Bartenstein: EU and Russia need a new -style energy partnership”, 16 March 2006. www.eu2006.at

¹³ Russia’s Putin Orders Oil Pipeline Rerouted Over Environmental Concerns, <http://www.mosnews.com/news/2006/04/26/putinpipe.shtml>

¹⁴ ‘Taking on the Bear’, *The Economist*, 07/05/2005; Press Conference following EU -Russia summit, 04/10/2005.

¹⁵ Hill, F. *Beyond Co-dependency: European Reliance on Russian Energy*, US-Europe Analysis Series, The Brookings Institution, 2005.

¹⁶ Smith, K.C. *Russian Energy Politics in the Baltics, Poland and Ukraine*. Washington : CSIS, 2004. pp.ix, 5; Leijonhielm, J. & R. Larsson, *Russia’s Strategic Commodities: Energy and Metals as Security Levers*. Oslo: Swedish Defence Research Agency, FOI, 2004. pp.129-30; Abdelal, R. *Interpreting Interdependence: Energy and Security in Ukraine and Belarus*. CSIS Working Paper, July 2002.

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