Can EU face Russia down over energy policy?

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Agnia Grigas [1] 18 March 2013
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Moscow uses energy as a geopolitical weapon and is thus in a strong position vis a vis the EU, 40% of whose gas supplies come from Russia. But new developments, including shale gas discoveries, are enabling Europe to retaliate and the outcome is not a foregone conclusion, says Agnia Grigas

Since 1999, when Vladimir Putin took the helm in Russia, Moscow has been using energy as a tool of geopolitical influence in Europe and Eurasia. Now, with Europe getting two fifths of its gas from Russia, the EU has been looking to challenge Russia's energy dominance with its Third Energy Package [8] 'unbundling' policies and the launch of an investigation into Gazprom's monopolistic practices.

Russia's energy policies

Since the beginning of the 00s, Russian energy policies have centred on a threefold agenda:

1. energy cuts to non-cooperative states;
2. acquisition of strategic energy assets abroad; and
3. re-orientation of energy transit routes.

These three aspects of Russia's policy have all been driven more by Moscow's commercial considerations of raising revenue than by politics, though not always. In the period since 2000 Russia has **cut off energy exports** on more than 50 occasions, most often to members of the Commonwealth of Independent States and to Eastern European states. While these cut-offs have often been criticised as political, in most cases they occurred when Moscow's political objectives and commercial interests coincided. The best-documented cuts were the successive gas stoppages to Ukraine (March 2005; March 2008; December 2008) and to Belarus in February 2004, which were prompted by tensions over Kiev's and Minsk's payment of their gas bill and the deterioration of bilateral political relations.

The most obviously politically-induced cut-offs have occurred in the Baltic states. When Russian investors were unable to acquire the Latvian port operator Ventspils Nafta [9] (2003) or the Lithuanian oil refinery Mažeikių Nafta [10] (2006), oil supplies to those facilities were cut off permanently. Estonia also suffered temporary interruptions to the rail deliveries of oil to during the political standoff [11] over a Soviet war memorial in May 2007. While the timing of the halts was determined by political tensions, they also coincided with the improved capacity of Russia's port of Primorsk [12] (north of St Petersburg), meaning that oil could be exported westward without relying on Baltic states transit routes.

By the 00s it had become a priority for Russia to ensure that the energy infrastructure was controlled by Russians, rather than transit countries. Specifically, that oil and gas would only be transited, transported or refined in Russian-owned infrastructure facilities. Russian national oil and gas companies **sought to acquire** transit networks, transport infrastructure, refineries and storage in transit states such as the Baltics, Ukraine, Belarus, Moldova, Armenia and others. If countries agreed – like Belarus – to sell their networks to Russian companies, then sometimes they received preferential treatment and prices. But temporarily rather than permanently, as in the cases of Moldova and Armenia. When countries refused to sell their transit infrastructure, Moscow sought to find another route – whatever the cost.

The acquisition strategy and the energy cut-offs have been closely tied to the third aspect of Russia's energy policy: the **purposeful re-orientation** of Russia's gas and oil export flows to Western clients, away from old routes via the east European states to new direct routes through Russian territory and ports. This re-orientation of energy flows was particularly targeted at those countries which resisted Russia's efforts to expand its presence in downstream markets through the acquisition of local gas providers and distributors; it was often initiated following political tensions with the state in question.

The first manifestation of this policy was in the Baltic oil sector. Latvia and Lithuania refused to sell their strategic assets, as described above, so Russia closed down the pipelines supplying Ventspils Nafta and Mažeikių Nafta and sought new routes. When Russia had updated its energy export infrastructure by completing the Baltic Pipeline System (BPS) in 2001 and the two Primorsk oil terminals in 2006 and 2008, it cut the Baltic states out of the oil transit business. Going forward, Russia aims to expand [13] BPS to bypass Belarus and the Baltic states completely, thus virtually doubling the capacity of its northwestern ports Ust-Luga, Primorsk, Vysotsk, Kaliningrad and Murmansk by 2015.

Another manifestation of this policy can be seen in the gas sector: Russian-led projects such as Nord Stream [14] and South Stream [15] aim to cut countries such as Ukraine and Belarus out of the gas transit business and to reach Western European consumers directly.

'Unbundling' Gazprom assets

By the late 00s Gazprom was pushing towards consolidating its downstream assets and using energy as a tool of influence. But the EU started pushing back. The Third European Energy Package of 2009 seeks to encourage competition in the energy sector, calling for the ownership of transmission system operators to be unbundled by hiving off gas and electricity transmission networks from their generation and sales operations.

Gazprom owns shares in pipeline infrastructure in a number of EU member states: Estonia (37% of Eesti Gaas), Finland (25% of Gasum Oy), Latvia (34% of Latvijas Gaze), Lithuania (37% of Lietuvos Dujos) and Poland (48% of EuRoPol). In the future it will probably own the South Stream pipeline infrastructure in Bulgaria. 'Ownership unbundling' would mean that Gazprom-owned gas distribution companies such as Eesti Gaas or Gasum Oy would have to sell their pipeline operations to someone who has no association with the gas industry, or to another network operator.

Of these six EU member states, only Lithuania has embarked on attempts to unbundle its national gas distribution company, Lietuvos Dujos. In 2012 Gazprom took its case [16] to international arbitration at the Stockholm Tribunal, but the decision was reached that unbundling should proceed, whatever the outcome of the case. Estonia has moved more slowly, but it also passed legislation in June 2012 to force Eesti Gaas to sell its pipeline unit by 2015.

EC investigation into Gazprom practices

While in Eastern Europe it has been long suspected that Gazprom sets its gas prices under guidance from the Kremlin, the EC has only recently embarked on scrutinising its pricing practices. In September 2012, following an official complaint from Lithuania, the European Commission Directorate General for Competition launched [17] a formal antitrust investigation against Gazprom practices in the EU. According to the European Commission, Gazprom actions are subject to investigation in eight markets – Poland, The Czech Republic, Slovakia, Hungary, Bulgaria, Estonia, Latvia and Lithuania.

The Commission is investigating three suspected anti-competitive practices in Central and Eastern Europe:

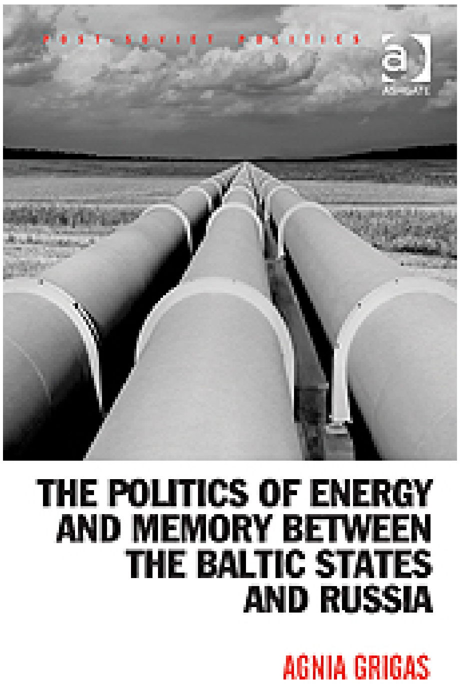
1. hindering the free flow of gas from one country to another;
2. preventing diversification of supply of gas; and
3. imposing unfair pricing through its oil-based gas pricing mechanisms.

While the process is under way, its outcome and subsequent effects are uncertain. The investigation can be viewed as the Commission putting pressure on Gazprom to alter its pricing model [18] from oil-linked to hub-based prices – a change Gazprom has strongly resisted. It can also be viewed as a signal from Brussels to Moscow that the EU is pushing back on the last decade of Russia's energy policies. However, considering that the new EU member states have spent the last twenty years trying to diversify their gas supplies away from Russia and have (mostly) failed, the investigation needs to consider and prepare for all possible outcomes. The Russians have ultimate power over countries with no alternative gas supplies; if the gas contracts are declared illegal or are terminated, the new EU member states might not be able to access Russian gas or other alternatives.

Success or challenges for the EU?

On the one hand, Russia may appear to have the advantage - Europe is increasingly dependent on Russian oil and gas and Putin seems determined to play the energy card to divide and conquer the EU member states. On the other, the concern of the most energy-vulnerable new EU member states is beginning to attract attention across European capitals. Furthermore, the new EU member states are starting to influence EU energy policy.

In fact, Russia's energy policies can only be as influential as European states will allow. EU energy policies, diversification, shale gas discoveries, and green energy initiatives will sooner or later diminish energy dependence on Russia and, therefore, its influence.



Dr Agnia Grigas is the author of *The Politics of Energy and Memory between the Baltic State and Russia* (Ashgate Publishing, January 2013)

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Dr Agnia Grigas spend a decade as a development and political risk consultant to corporations and government. She currently works in business and academia and is the author of *The Politics of Energy and Memory between the Baltic States and Russia* (Ashgate Publishing, January 2013).

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