Russia and the Politics of Gas Market Integration in Europe

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Main messages

• Europe’s problem with Russian gas is not over-dependence but political divisiveness

• Divisiveness is exacerbated by market segmentation

• Europe would derive geopolitical benefits from an integrated, competitive gas market

• There are foreign policy dimensions to Germany’s opposition to gas market integration
Three dimensions of energy security

• Disruption risk
  – Macro-economic cost of energy supply disruptions

• Scarcity risk
  – Long-term price of energy

• Dependence risk
  – Burden on foreign policy

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

• 1980s: gas shielded from cold war politics
  – Strong US resistance to Europe’s “dependence” on USSR
  – Keeping gas out of the cold war key condition for the relationship to develop

• 2000s: Putin’s Russia broke the implicit contract
  – Politicisation of Gazprom’s management
  – Gas export policy at the service of Russia’s European policy
  – Development of an ambitious European policy based on exploiting and reinforcing Europe’s divisions

• EU is still wondering how to respond
  – “Dependence is a threat” v. “Russia is reliable”
  – Energy diplomacy towards Russia is failing – “EU-Russia energy dialogue”; ECT; new PCA negotiations
European gas supply has been diversifying

...Yet Russian gas is more and more divisive in Europe

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

Russia’s share of imports has been halved since 1980

Source: Eurostat; BP Statistical Review of World Energy
Imports from Russia as a share of primary gas supply in various countries.

- Eastern Europe is highly dependent on Russia
- Supply diversity is in Western Europe
Western Europe takes the bulk of Russian gas.
Geopolitics of segmented EU gas market

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

Source: BP Statistical Review; Eurostat
Market integration would help reduce the divisiveness of Russian gas

• Germany and Italy merged into a highly diversified Western European market

• Supply diversity could move eastward
  – Poland, Hungary, Czech Rep. -- *not Baltic states*

• Increase collective supply security
  – A wider market means more arbitrage possibilities – reallocation of supply in time of crisis

• Change the conditions of access to Russian gas
  – Bilateral import contracts would be “Europeanised”
Resistance to market integration

• “Traditionalists vs. New Economy” (2001)
  – Liberalisation / integration compromises “energy security”
  – Little has changed – at least in Germany

• EU / economists’ view: anti-competitive behaviour
  – Defending dominant positions on national markets

• Foreign policy dimension – *Insights from Germany*
  – Preserving its “strategic partnership” with Russia…
  – …means keeping the gas relationship entirely bilateral
  – Avoiding at any cost gas “solidarity” with Eastern Europe –
    Because they behave “irresponsibly” vis-à-vis Russia

• German government more “traditionalist” than cpies.
Resistance to market integration (2)

- “Gas market liberalisation in Europe is the most stupid idea in modern economic history.”
  
### Position on Russia v. position on unbundling

#### ECFR EU-Russia Power Audit

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<th>Foreign policy attitude towards Russia (ECFR)</th>
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#### Izvestia "Русский вопрос" расколол Европу" (2 Sept 2008)

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Concluding thoughts

• Market integration is just one element
  – Supply security standards – investment in supply security in Central & Eastern Europe

• Building a gas market should be a (real) priority
  – Will the “3rd package” deliver?
  – Who wants to spend political capital on it?

• How to overcome German resistance to market integration and European solidarity?

• Will energy policies reflect the political cost associated to Russian gas? How?