



Trust and European-Russian Energy Relations – The Case of Oil and Gas Partnerships and Long Term Contracts

Marc Ozawa

EPRG, University of Cambridge

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Presentation Overview

1. Why focus on trust?
2. Introduction to research project
3. Findings
4. Implications and questions

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Two Perspectives in Western Europe

Why so different?

Germany-Russia



Gas investments along entire value chain—
upstream and downstream

Stable and long term contracts; disputes
resolved privately

Productive commercial and political
relations

UK-Russia



Volatile oil investment and failed gas
investment.

Very public disputes between partners
leading to litigation

Contentious commercial and political
relations

Emergence of trust

In interviews with policy makers and company employees, trust came up repeatedly as a determining factor for cooperation.

“We work better with the Germans because we know each other, and they don’t try to control us. We can trust them.”

“Trust is the glue that holds it all together. Without it, you can’t begin. If you lose it, the project falls apart.”



Dr. Leonid Grigoriev

Director Russian Institute
Energy and Finance

Member, EU-Russia Energy
Dialogue



Bjørn Tore Godal

Statoil, Board of
Directors

Constraints necessitating trust in gas negotiations

- No substantive multilateral trade regime providing negotiations framework
- No robust enforcement mechanisms for dispute settlement
- High start up costs
- Political and economic ramifications
- Geopolitical context

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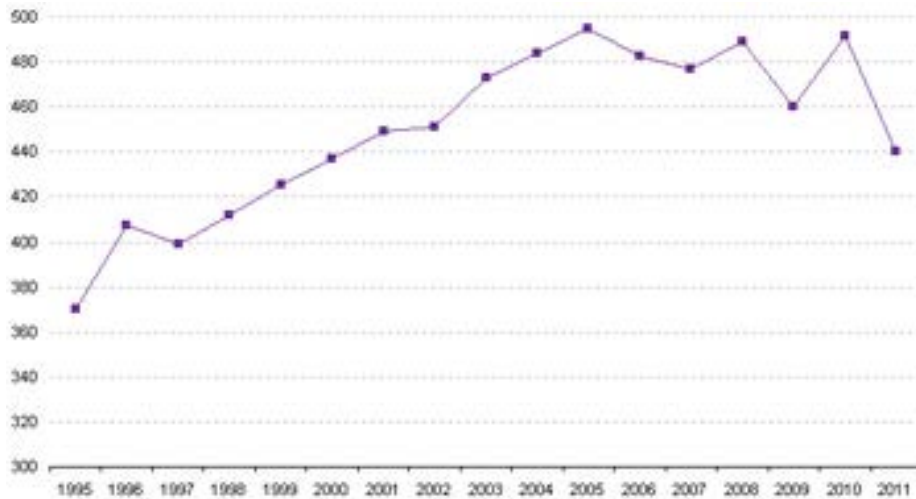
European-Russian Energy Relations

Mutual interdependence: Europe as consumer and Russia as supplier

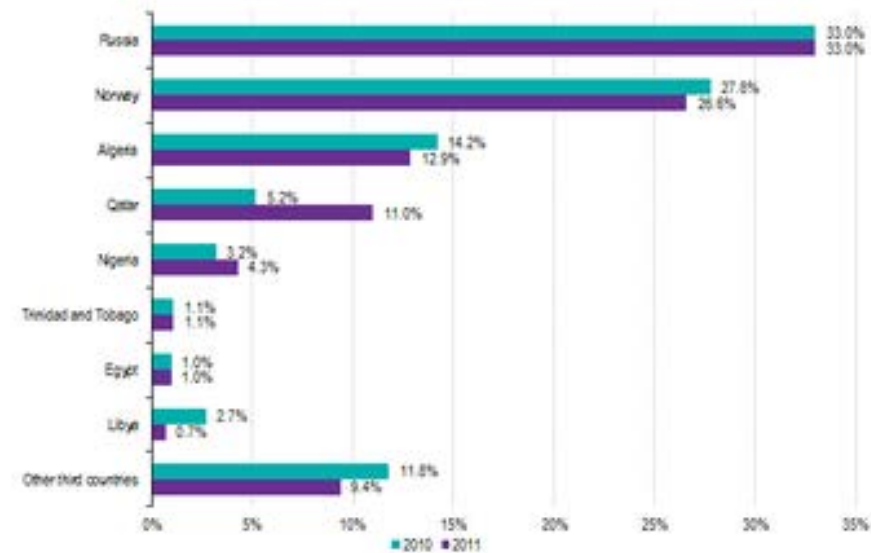
Europe is largest gas market in the world: 496 million tons (2010)

Russia is Europe's largest supplier: 33%

E.U. and state level relations



Provisional data for 2011



Provisional data for 2011

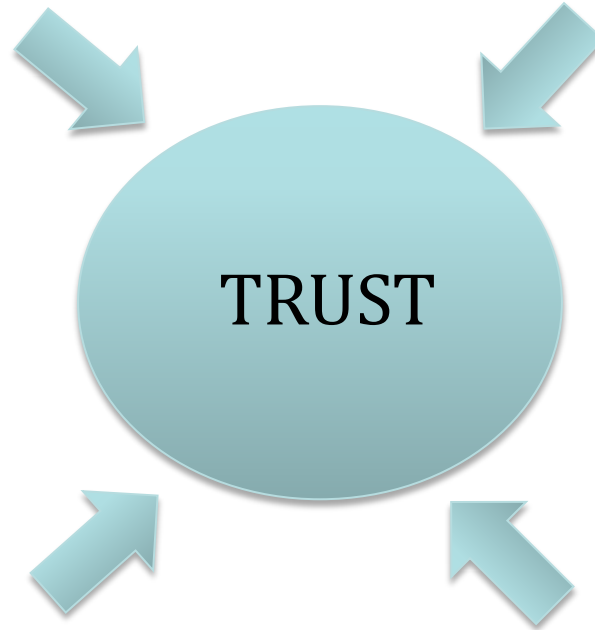
Source: Eurostat

Methodology

Triangulation Approach – Multiple Empirical Analyses

Semi-structured interviews

Historical process tracing



Subject observation –
ethnography

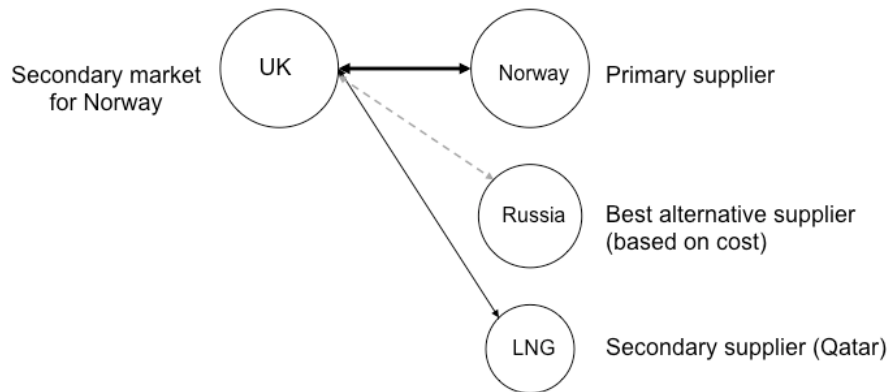
Analysis of public & private
statements

Methodology (cont.)

Case comparison of joint ventures and long term contracts

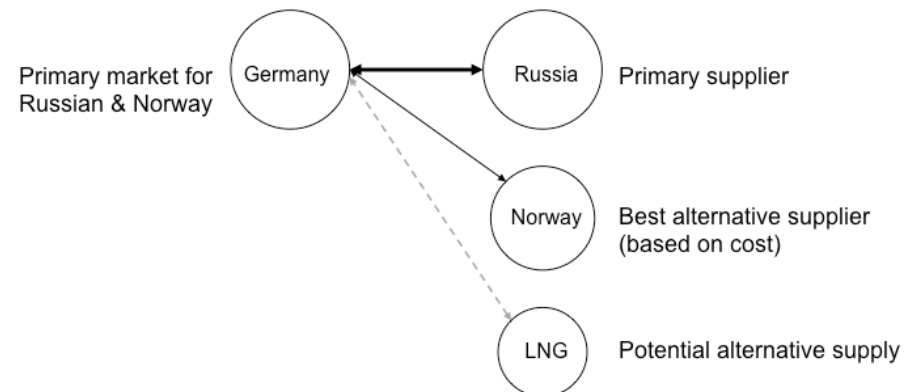
1. Germany – Russia: High trust case
2. U.K. – Russia: Low trust case
3. Norway and LNG as BATNA cases
4. Japan, Kazakhstan, Qatar, U.S. and Canada (reference cases)

CASE 1: UK-RUSSIA-NORWAY



— Denotes high level of interaction (trade and joint ventures)
— Denotes middle level of interaction (trade and joint ventures)
- - - - Denotes little or no interaction

CASE 2: GERMANY-RUSSIA-NORWAY



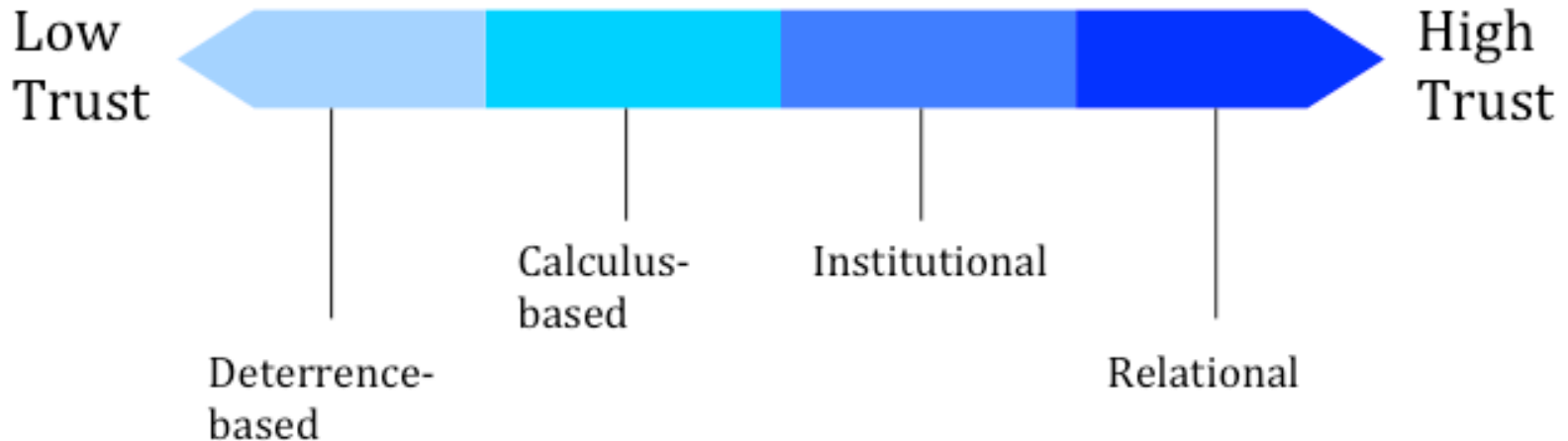
— Denotes high level of interaction (trade and joint ventures)
— Denotes middle level of interaction (trade and joint ventures)
- - - - Denotes little or no interaction

What is trust?

Most common social science conception – trust is the belief that others are willing to reciprocate cooperation in the future (Bacharach and Gambetta, 2001; Kydd, 2005)

Trust as a ‘meso-concept’

The body of work suggests that it may be a ‘meso-concept’, integrating microlevel psychological processes and group dynamics with institutional arrangements (House, Rousseau, and Thomas-Hunt, 1998)



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Findings (effects of trust)

Germany-Russia



Influenced preferences to engage with partner

Influenced scope of first partnership

Minimised effects of dispute

Deepened level of cooperation after dispute

UK-Russia



Influenced preferences to engage with partner

Politics was used as a tool of coercion rather than cooperation

Dispute led to attempts to defect from relationship

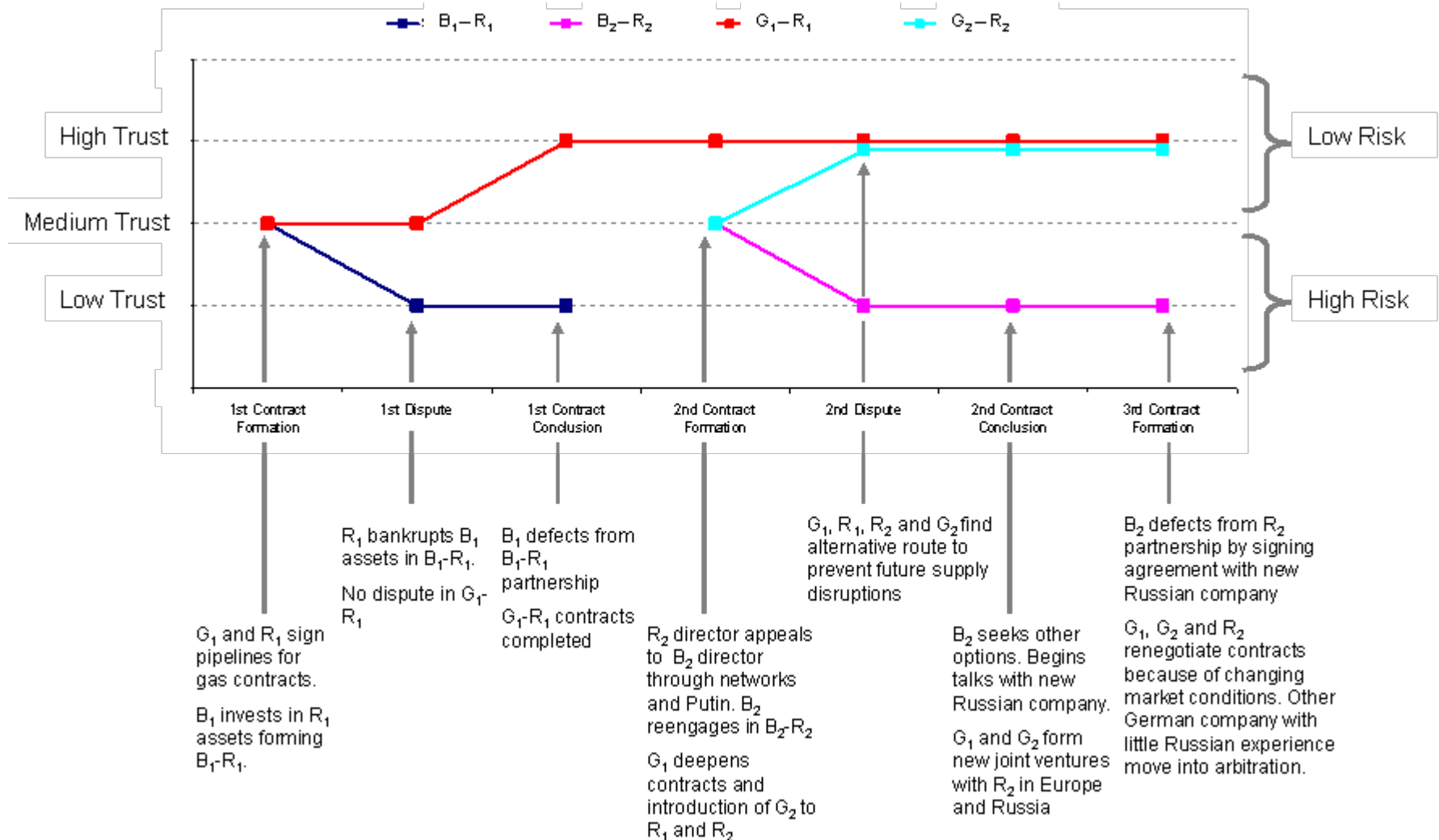
Findings

- ‘High trust’ and ‘low trust’ cultures – There are distinct behavioural preferences whereby Russian actors emphasised relationships and social interaction over contracts whereas British and Norwegian focus was on contracts and process.
- Relationships and trade institutions are mutually opposed – with the development of trade institutions, relationships become less important as learned behaviour changes over time. In East, trust appears to function as a trade institution in lieu of formal contracts – historical legacies (*bumaga terpit’ vsye*)
- German actors appeared comfortable in both environments.
- Social interaction and interpersonal relationships defined the most stable European-Russian partnerships (*Saunapolitik*)
- Language played an important role by allowing negotiators to communicate directly in informal settings – it promoted social interactions and the development of interpersonal relationships
- Level of trust became less flexible over time. Once opinions formed it became progressively difficult to change them.

Joint venture profiles

B_1-R_1	G_1-R_1	N_1-R_1
Oil joint ventures Exploration & production Onshore (Russia)	Gas joint venture Pipelines for gas Onshore (FRG, GDR, Poland, USSR)	Gas joint venture Exploration & production Offshore Pipeline transported & LNG (Russia)
B_2-R_2	G_2-R_2	N_2-R_2
Oil and gas joint venture Exploration & production Onshore Pipeline transported (for gas) (Russia)	Oil and gas joint ventures Exploration & production Onshore Pipeline transported (for gas) (Germany, Russia and across Europe)	Oil joint venture Exploration & production Onshore & offshore (Norway & Russia)

Trust formation stages



Trusting, Fast & Slow

(Trust formation in Kahneman's framework - evaluating trustworthiness)

Shared history, either positive or negative

Ideological legacy

Stereotypes and associations

Cultural affinity

Reference cases

Perceived social contract

1st System

(Based on associations)

Fast evaluations

Default preference for cognitive process

Fulfilling expectations

Signalling interest (costly signalling)

Previously observed behaviour

Demonstrated expertise

2nd System

(Rational & reflective)

Slow evaluations

More effort required for cognitive process

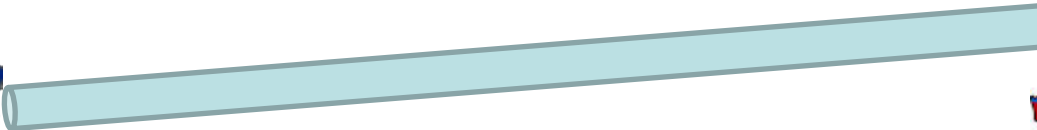


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Obstacles Facing UK-Russian Negotiations

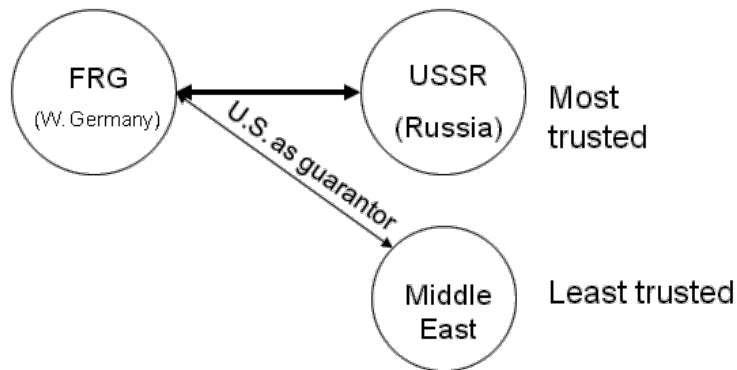
- Memories and associations do not promote trustworthiness
- Previous interactions were limited and contentious
- Poor political relations
- Business practices are opposed, social emphasis v. technocratic processes
- Today cards are stacked again Nord Stream 3 & 4 from a trust perspective BUT more favourable than Germany and Russia when that relationship began



Ostpolitik - a model for building trust?

- Policy of rapprochement between the FRG (West Germany) and USSR
- Informal back channel of communication was critical to building trust
- Driven by mutual interest in trade and political stability – original policy was conceived and lobbied by industrial firms
- Breakthrough in negotiations occurred between Foreign Minister Egon Bahr and Soviet negotiators – FRG had to balance concerns in Washington for a gas trade deal.
- Outcome – “pipelines for supply deal” – barter structure for first LTC between German consortium headed by Ruhrgas and the Soviet Ministry of Petroleum & Minerals

FRG'S CHOICE - WHOM TO TRUST?



Implications

- Appears to be two different trust dynamics in gas cooperation
 1. Transactional (low trust culture), based on contracts, process and international conventions – this dynamic is a low level of trust because of lower vulnerability, however, it yields shorter term cooperation and is less flexible under changing circumstances
 1. Relational (high trust culture), based on explicit and implicit expectations communicated between actors through repeated professional and social interaction – this is a high level of trust because of higher vulnerability, but it is more flexible and promotes higher levels of cooperation compared to transactional trust
- Relational trust is likely to be more effective with partners from regions with low levels of energy governance (where government and commercial institutions are less developed, ergo most of the world)
- Gas is more political than oil and requires higher level of trust
- Building trust for partnerships will require interaction at both commercial and political levels – this may be uncomfortable for some European politicians

Questions: 1. How important is trust?

Its importance varies depending on the partners. Typically, relational trust is more important in partnerships involving participants in countries with less developed trade institutions. Because of previously mentioned circumstances

In countries with nascent trade institutions, relational trust is a requirement to initiate and maintain the partnership. Without trust, the risk is tantamount to making an investment without a contract and no enforcement mechanisms.

Investment cost \leq value of trust

Extreme example: Nationalisation of assets

Even in countries with developed trade institutions, trust is likely to influence preferences of decision makers, all things being equal.

- I. Partnership vetting
- II. Dispute or breach of contract
- III. Conclusion of contract – end partnership, renew or expand partnership?

How important is trust? (cont.)

The Opportunity Cost of Distrust

Examples from the cases:

1. BP in Russia – 8 years of stranded gas assets (Kovytko field) at the height of the European gas market; two new projects in Iraq and Vietnam to which it no longer has access; partnership with Rosneft that now belongs to ExxonMobil
2. Statoil and Rosneft – loss of top field licenses in Barents Sea, best fields were assigned to ENI and ExxonMobil despite Statoil's greater experience in developing fields in the Norwegian-Russian maritime border region
3. Russian-Japanese collaboration – most partnerships have failed since the 1970s, and current cooperation is constrained by distrust resulting from the border dispute; after Fukushima, Japan's energy security premium has doubled despite the most obvious gas source at its border
4. Energy security premium for eastern European states

2. What causes distrust?

- If one or more partners come from a 'high trust' culture, little or no social interactions among negotiators can cause distrust
- Lack of regional specialists as part of the negotiations process, this become more important when or more partners is from a 'high trust' culture
- Not fulfilling expectations
- Excessive risk aversion
- Infrequent communication
- Associative factors (1st system) depending on the individual partners
- Misalignment of high trust/low trust signals

3. What can companies do to improve trust in natural gas partnerships?

- People, people, people (human capital issue) - Recruit and assign the right people, especially in positions of leadership and negotiations (points of contact with the partnership's counterparts) and ensure they have the appropriate 'soft skills', generally speaking, regional specialists who speak the language and understand the culture
- Raise the level of social interaction in addition to formal meetings if one or more parties are from 'high trust' cultures
- Create a 'trust' channel for communication
- Take risk (within reason after initial assessment) that sends the right signals
- Create a list of signals that both sides understand
- Devise a strategy to address the '1st System factors'
- Identity both explicit and implicit expectations, and fulfill them – expectations will vary depending on cultural preferences (high or low trust cultures)