

The European Gas Puzzle: Over-Securitization, Dilemmas and Multi-level Gas Politics on the European Continent a Year after ‘Euromaidan’

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At the end of 2014 the European energy landscape looks much different from that a year ago: Russian Crimea annexation, military conflict and continuing destabilization in Eastern Ukraine have brought a sharp deterioration in overall political relations with Russia. The fall-out on EU energy policy is severe: geopolitics and (over)-securitization have come to prevail over economic interests or climate concerns. As the image of natural gas is flawed, this has implications for natural gas policies and relations with other major suppliers, Norway among them. The European gas puzzle consists of many pieces, and the picture is sketchy as multilevel gas politics continue to unfold. A blueprint of how the EU wants to see the pieces fit together is needed.

First Piece in the Puzzle: Ukraine – From Transit Issue to Solidarity Issue?

Ukraine still hosts the largest transport corridor for Russian gas deliveries to Europe. In 2014, roughly 40% of Russia's 160 bcm of natural gas exports have passed through Ukraine to Europe. Transit is functioning normally, but supplies to Ukraine have become a pressing issue.

Over the course of 2013/2014 gas relations between Moscow and Kiev have served as a battlefield for the much greater military conflict and precarious security situation in Eastern Ukraine. In 2013 Ukraine imported 25.8 bcm from Russia, towards its total annual consumption of 50.3 bcm, but from mid-June 2014, Russian gas deliveries under the 2009 Gazprom-Naftohaz contract were halted. It took until the end of October for the EU, Russia and Ukraine to achieve a provisional trilateral agreement on a *modus operandi* for the 2014/2015 winter period. For longer-term resolution of the conflict over debts and gas prices, Kiev and Moscow have started arbitration proceedings – the former on the prices, the latter on unpaid bills.

For the EU, the qualitative change is that case of Ukraine is shifting from being a transit issue into a ‘solidarity challenge’. For obvious political but also commercial reasons, European companies have carried out reverse-flow activities which could reach 17bcm/annually. However, that gas actually originates from Russia and relies on the European market's gas stocks. If for any reason Russian deliveries through Ukraine are halted or generally curbed, reverse-flow deliveries would become politically and economically difficult, because the gas will be needed in the EU.

The solidarity challenge extends far beyond this winter because the structural and systemic problems of Ukraine are paramount issues. Aside from managing the immediate crisis, however, assistance can hardly be extended into the future without conditionality and monitoring the necessary reforms. As a member of the Energy Community Ukraine will have to fully implement the legal acts of the EU Energy Acquis Communautaire. This will also require a new transport and storage scheme. How this will affect the supply-security equation of both, Ukraine and the EU, remains to be seen.

Second Piece in the Puzzle: Russian–EU Relations: Loss of Trust, Lack of Reliability?

The annexation of Crimea and the destabilization of Eastern Ukraine have resulted in a severe crisis of confidence between Russia and the EU, in turn shaking up the political order on the continent as a whole. Mistrust, misperceptions and misunderstandings reign on both sides. Economic sanctions aggravate the discord. Because of the deterioration in political relations, Russian gas supplies are no longer perceived as reliable by the political elite in the EU – fears that Russia will use natural gas deliveries as a political tool grow more pronounced, whereas voices noting that Russia has never cut off a (well-) paying customer become more subdued.

Crimean annexation and destabilization in Eastern Ukraine are challenging the paradigm of mutual political and economic benefits. Nowhere is the impact of the political deterioration as evident as in Germany, where the gas pipeline deals of the 1970s were part of Ostpolitik. Positive political framing of the gas trade with the Soviet Union/ Russia built on 'change through rapprochement', later becoming the 'modernization partnership'. In the past, mutual interdependence had paved the way for an ever-closer energy partnership. Today, (inter)dependence is viewed as part of the problem (by limiting the room for political manoeuvre) and no longer as part of the solution (achieving an increasingly close partnership with Russia). The EU has to diminish dependency on Russian gas imports, where it creates vulnerability and opportunities for political pressure. The best way forward is to create a functioning and interconnected EU gas market, though.

Third Piece in the Puzzle: From Interdependence to Proactive Diversification?

For the time being, Europe remains dependent on Russian gas deliveries. Russia is EU's main energy supplier, with more than 166 bcm in 2013 meeting about 30% of the EU's gas consumption. The levels of the Russian share in consumption differ widely across the continent. Russia has market power on a continental scale, also because it retains the possibility of out pricing other sources of natural gas e.g. North American LNG. Moreover, up to the mid-2020s, European gas companies have obligations to import at least 115bcm/a under existing contracts. In sum, the EU's has limited opportunities to diversify in short-term, but increasing options from mid- to long-term. However, a proactive diversification will come at significant costs. EU's own gas fields are depleting. Besides Russia, the traditional suppliers Norway and Algeria continue to play a central role. However, Algeria has reached a production plateau, and is facing increasing internal demand. Norway has some leeway, but here there are limits in the short term. The LNG supply is certain to improve from 2016/17 onwards, and by 2020 the world might even see a surplus. However, LNG will not be cheap. Moreover, much will depend on price and demand developments in Asia. The potential profits are higher there, and the region promises growth.

In sum, sound diversification can be accomplished only incrementally. EU's competitiveness is depending to a large extent on affordable and available energy supplies from Russia as long as the conventional energy system persists. Mutual dependence cuts both ways: Russia is heavily dependent on the income from its energy exports. Oil and gas – with most going to Europe – make up almost 70% of Russian exports; they stand for more than 40% of budget revenues, of which only about 5% originates from natural gas. Some 32% of Gazprom revenues stem from sales to Europe. The oil price slump has been hitting the Russian economy severely. It has been estimated that Russia needs an oil price of about USD

115 per barrel to secure a balanced budget in 2014. For 2015, the fiscal break-even point is reported to be at USD 80/barrel. The Russian economy is increasingly fragile. Radical shifts in energy strategies are to the disadvantage of both sides. Russia's orientation to China with the two pipeline projects of Power of Siberia (38 bcm/a) and Altai Pipeline (30bcm/a) may be part of diversification, but the selling-out of Russian oil and gas deposits is neither in the interest of Russia nor the EU. Energy relations are stalled by geopolitics.

Fourth Piece in the Puzzle: Business as Usual: Immunity or Infection?

If economic rationality prevailed on both sides, neither Russia nor the European Union would have any interest in endangering their energy relations. But the hope that existing commercial relations will prove immune to the deterioration and that business can be separated from geopolitics is vanishing.

Trade relations in natural gas are increasingly affected. The embittered atmosphere impeded the EU and Russia in solving contentious issues that have been on the table even before the Annexation of Crimea and the conflict in Eastern Ukraine. Since then, bilateral EU-Russian talks to settle these issues related to the implementation of Third Market Packages have been put on hold by the EU Commission. Despite of the trilateral preliminary agreement for Ukrainian winter supplies, progress has not been sought by the EU on OPAL, South Stream or the Antitrust Case against Gazprom. On her part, Russia has decided in December 2014 to abandon South Stream and to withdraw from the compromise on OPAL achieved by the German regulatory authority after the Commission has not given its approval. These developments do have an immediate impact on business strategies, corporate relations and are contributing to uncertainty and mistrust. South-East Europe, Austria and Italy are among the areas and countries that must rethink their natural gas strategies after the decision to abandon South Stream and to make Turkey a major trading hub. The *modus operandi* of gas relations is at stake. Most likely, 2015/16 will see new clashes on network codes and the re-negotiation of new long-term contracts.

Business as usual is becoming increasingly difficult as the stumbling blocks multiply. Politics/geopolitics are shaped by perceptions – and the longer the crisis lasts, the more difficult will it be to marry them with economic rationalities.

Fifth Piece in the Puzzle: The Paradox of 2030 Package and an Energy Union: Addressing or Squeezing Out Natural Gas?

There are principle decisions ahead in EU policies: What role for natural gas in the future energy mix? How to re-shape external energy relations? When it comes to natural gas the two questions are interrelated. Natural gas can contribute to decarbonisation but a proactive diversification will increase the cost disadvantage gas has compared to coal. In that

respect painful trade-offs have to be faced with regard to climate ambitions. Competitiveness is closely related to EU access to stable, secure and affordable energy. As Russia is a major supplier of oil, gas, coal and nuclear fuel rods and reactor technology political values and economic interests are running counter to each other.

Within the EU, the best way forward is an integrated internal market and a more sustainable energy system. However, 2014 has produced a highly ambiguous outcome of EU policies in that respect. Energy security – primarily related to natural gas – has rhetorically dominated the agenda. The paradox stems from the 2030 framework to which the EU member-states agreed in late October 2014. This allows each member-state to continue with its own national energy mix, and intensifies ambiguity in energy policies and fragmentation in EU energy markets. At the same time, an Energy Union is envisaged, basing on solidarity, trust and a functioning internal market. Greater unity and unanimity are stipulated.

With respect to natural gas, future EU consumption patterns are difficult to foresee. Yet, predictability of demand is a necessary precondition to weigh costs and benefits of further security of supply provisions. Diversification as well as increasing flexibility and resilience internally come at significant costs. They are affordable only in European concert. The lack of a clear energy and climate policy framework putting the EU on a decarbonisation path obstructs effective policy steps. The ‘muddling through’ approach makes the EU an uncertain partner for (alternative) suppliers of natural gas. The EU faces multiple dilemmas.

Conclusions: The Wider Topology of the Puzzle and the Necessity for a Blueprint

Putting the pieces of the puzzle together has to take different rationales into the picture: Firstly, solidarity within the EU has to be preserved. Relations with Russia and the Russian–Ukrainian gas conflicts have long been a fulcrum and flash-point of EU foreign and energy policy. Secondly, assistance has to be granted to Ukraine to preserve its statehood and sovereignty. This will certainly require lasting political dedication, and huge political and financial resources. However, political stability and economic welfare for Ukraine cannot be achieved without Russia, and definitely not *against* Russia. The third rationale is to face the fact that Russia will stay on the continent, as a neighbour and a gas producer. Achieving a new *modus vivendi* for energy relations with a long-term vision should be the blueprint.

Containment in reaction to Russia’s violation of the security order has to be hold up, but at the same time the EU and Russia should avert further damage on energy relations, restore back channels for dialogue that allow to ensure smooth gas trade. EU and Russia have to re-engage as soon as possible in formulating compromises defining a *modus of operandi*. It is increasingly problematic from an energy informed perspec-

tive that energy relations are held hostage of geopolitics. This is detrimental to economic relations that have traditionally functioned to balancing interests and building confidence.

In a wider perspective, the natural gas challenge is closely related to EU’s future foreign and security policies. The neighbourhood of the South and Eastern Mediterranean and the wider Caspian region (as well as Russia) is of strategic importance for European energy supplies.

Norway is a key partner to the EU and this relationship should gain more attention. Norway will have to invest into exploration and production in more difficult areas and will certainly not do so if the EU does not reduce regulatory and political uncertainties surrounding its future climate and energy policy. Long-term mechanisms to achieve demand and supply security should be developed in a close dialogue. Neither Norway nor the EU can simply live on each other’s vague promises.

Literature

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