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Geopolitical Implications of Russia's Energy Policies

Keith Smith, CSIS senior associate, discusses the suspicious agreement between Russia and Ukraine on natural gas supplies.

The recent dispute between Russia and Ukraine in the ongoing war over the supply and demand of natural gas highlighted the geopolitical implications of Russia's energy policies. On January 20, the Office of the Director of Studies hosted a discussion on this topic led by Ambassador Keith Smith, senior associate in the Europe Program. His opening remarks were followed by comments from Lisa Hyland (program coordinator, Energy Program), Milena Staneva (research associate, New European Democracies Project), Nathan Puffer (research assistant, Russia and Eurasia Program), and Raffaello Pantucci (research associate, Europe Program).

Ambassador Smith placed the events of December 2005 in a context stretching back to the fall of the Soviet Union in 1991. He painted an artfully confused picture of the ownership of the various energy and pipeline companies that are essential to the delivery of Russian natural gas to Europe and implied a level of corruption across the industry that illustrated why a technically perfect solution probably would not work in practice. Moreover, he pointed out that although the rate wanted by Russia ($230 per 1,000 cubic meters) was indeed the market rate, the fact that Ukraine had previously been paying $50 per 1,000 cubic meters meant that this "adjustment" would destroy their economy and deprive the country of heating during the coldest part of the winter. During the dispute, Russia appeared surprised by the level of support that Ukraine received from the international community, and the result was a diplomatic disaster for Moscow. The final agreement appears to have set a price around $100 per 1,000 cubic meters but lasts for only six months. The new company set up to own the pipeline system appears as complex and opaque as that that existed before.

Hyland: Energy markets are integrated—Europe should diversify

Although the recent natural gas crisis between Russia and Ukraine has significant political implications, from an energy security perspective, these events serve as a reminder of the simple but strategically critical fact that energy markets are integrated. The lessons for Europe are not new: when dependent on energy sources no longer produced domestically, seek diversity of supplier and transit routes; and when possible, avoid dependence on a single energy choice—diversify the resources used. Further, Europe should expect this type of action to reoccur.

If these lessons are taken seriously, a number of policy prescriptions emerge. If Russia is to be a long-term and major natural gas supplier to the EU and an oil supplier to the world (as seems apparent), the EU and the United States should call for increased transparency and reform in the energy sector. The question of Russia's accession to the World Trade Organization is an important one that will provide leverage to support these demands. The fact that the Russian energy industry has suffered from overregulation by the state and a lack of investment also gives leverage to the EU as Russian companies begin to seek foreign investment to maintain or increase their production.

To alleviate another crisis in the near term, EU members and the Ukraine can build more storage for natural gas and new pipelines; seek more gas suppliers, including the addition of liquefied natural gas (LNG); and seek greater efficiency from their industrial sectors. To reduce overall dependence on natural gas, Europe will have to consider alternatives to produce electric

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Upcoming Strategy Hour

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Domestic Surveillance for National Security

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4CR—9:00 a.m.

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Featured speaker:

Jason Keiber, Research Assistant, Technology and Public Policy Program

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power. The options will vary depending on domestic resources, but they include expanding or building new nuclear power plants; clean-coal technology; and renewable sources, especially wind and biomass.

Pantucci: Change will come from Europe's capitals

The key lesson learned about the European Union in 2005 is that when someone is looking for leadership in the EU, they are best served by considering what the capitals are saying. Hence, when confronting the Russian decision to turn off the taps to the Ukraine, one should look to the West European capitals that will be the most impacted: Berlin and Rome. They are, respectively, reliant on Russia for 39 percent and 30 percent of the gas they consume. For Rome in particular, this figure's importance is multiplied by the fact that Italy is reliant on gas to produce more than 50 percent of its electricity. This is not to dismiss the concerns of East and Baltic European states (who are in some cases reliant on Russia for 100 percent of their gas), but the truth in the EU is that agreements tend to be built around the bigger capitals.

At the same time, the smaller members should draw comfort from the fact that both Rome and Berlin are undergoing or about to undergo political facelifts. Angela Merkel has already indicated she intends to shift from her predecessor's instinctively pro-Russian stance and take a more nuanced approach. Ultimately, her concern will be securing German gas supplies, but she has already shown herself eager to talk about a Union of 25, and she was widely applauded in her efforts to broker a deal over the EU budget that took into account the concerns of smaller member states.

Whoever wins the April 9 general election in Italy—be it the incumbent, Silvio Berlusconi, or the challenger, former European Commission president Romano Prodi—they will be forced into a situation of having to deal with Italian dependence on Russian gas. The national energy supplier, Eni, has already reported that it has received less gas from Gazprom than it had requested at the beginning of the year, forcing the government to ask people to turn the heating down in their homes. This is not the sort of public announcement that the government will want to make during an election campaign. Suffice to say, whoever moves in to Palazzo Chigi on April 10 will be interested in taking a line with Moscow that more closely mirrors Brussels's skeptical Russian outlook.

Puffer: Identifying Russia's intentions

Russian intentions during the recent gas crisis in Ukraine will remain unclear. Even with the surrounding facts, neither Western experts nor Ukrainian politicians can definitively conclude that price adjustments were solely an attempt to influence Ukrainian politics. At the same time, the current situation in Belarus, though not identical, poses some challenging comparisons.

Unlike Ukraine, Belarus has been and remains much closer to Russian political sensibilities. Its leader and last European dictator, Alexander Lukashenko, has repeatedly voiced interest in a close union with Russia. Belarus receives economic support from Russia and, until recently, bought gas at prices on par with Ukraine. Moreover, Boris Gryzlov, speaker of Russia's Duma, recently announced that a constitutional referendum on a closer union between the two countries could be expected this year. So how does a struggle for influence play out when Belarus too faces elections, not parliamentarian as in Ukraine, but of the president, a man whose ability to avoid revolution in March may rest on a population kept complacent through economic support from Russia?

Unlike Belarus, Russia has little to lose by challenging the political and economic stability of Ukraine through dramatically increased energy prices. A similar move in Belarus could endanger Kremlin designs on maintaining a subordinate regime. When we factor in Belarus stumbling in its commitment to a closer relationship with Russia, such as adopting the Russian ruble as its official currency, the picture becomes clearer. The result appears to be Ukraine paying nearly twice as much to heat its homes and factories, while Belarus can be secure purchasing cheap Russian gas even if it must continue to play a subordinate role in the two countries' relations.