European dependency on Russian gas – discussion paper

This is the executive summary of a report by Sund Energy AS upon request from the Norwegian Ministry of Foreign Affairs as external input to a discussion on the role of Russian gas in Europe.
The views expressed are those of Sund Energy.
Russian gas accounts for 39% of the total EU gas import and 27% of total gas consumption. This share is higher in the eastern countries. There is a noticeable change in attitudes toward Russian gas in the EU, especially after the recent crisis in Ukraine. Since 2006, the EU has had rising supply security fears related to Russian gas in Europe, and a growing preference for renewable energy, energy efficiency and gas from non-Russian sources.

What is the real story?

The EU gas market is large and has developed with some own production and increasingly more imports from Russia, Algeria, Norway, and global LNG. From traditional nation-to-nation agreements there is now a liberalised market in most countries and contracts are signed between companies. The EU has been concerned about a *growing import dependency* since the 90s, as demand grew while European production fell. Infrastructure has traditionally been built from east to west and from the North Sea to north-western Europe. The EU has launched many initiatives (since 2000) to improve the internal market with better internal infrastructure with special attention and support to interconnectors, reversible pipelines and a north-south route. In addition, the EU has had several plans for a southern corridor to pipe more gas from the Caspian area.
There have been three well-known cut-offs of Russian gas to the Ukraine (2006, 2009 and 2014), and these have been interpreted by most observers to be politically motivated. *Ukraine* now imports more gas from the west, primarily through "reverse flow" and swaps. Demand has fallen significantly, making it possible to conceive a future without Russian supplies.
The narrative from Russia is that Gazprom has been keen to deliver with high regularity to European buyers and several pipelines have been built to avoid being too dependent on the Ukrainian transit route. By the time suppliers could have started delivering gas, the market had changed: lower demand and prices than expected, and the license to operate of Gazprom was restricted by new regulations. There is also an anti-trust case brought against Gazprom. Together, this gives the impression of unfair treatment of Russia – the EU does not want to be friendly any more. For Gazprom, it is more attractive to develop new markets with new pipelines and LNG. The narrative in Europe is different. After years of regular supplies and welcoming Russia as a member of WTO and open to business, there is now profound distrust. Immediately after the Russian annexation of Crimea, a stress test was performed by the EU to estimate impacts of a full cut-off of gas exports from Russia, and a strategy for how to deal with such a situation was developed. The result is an even stronger push for energy efficiency and renewable energy. In February, the "Energy Union" was launched, working for a more united energy policy without the joint buying originally envisioned.

Does Russia use gas as a foreign policy tool?

Yes, gas is part of the Russian political tool box, and has been for decades. Initially, the Soviet Union wanted to make countries and regions dependent on the cheap gas they delivered. This also gave a competitive advantage to manufacturing in the receiving areas. Exports to other countries, outside the Warsaw Pact, were priced higher and in foreign currency. At the end of the cold war, the EU and USA had an initiative to reduce this income, partly by speeding up Norwegian gas sales. This was interpreted as a "weapon" in Russia.
In later years, Russia has wanted more market level prices from their large buyers, resulting in high increases for some former Soviet Union countries. However, using lower-priced gas as a reward for alignment with Russian interests and "friendship", is still the case in Belarus, where prices remain very low. Further, a new dialogue with China, Turkey and Hungary could also have an element of "friendly" pricing or routing/re-routing for stronger political relations.
There is now almost consensus in Europe that Russian gas is political and that higher prices and pre-payment in Ukraine is a punishment of the more West-leaning regime. Much has been written about this, both in the media and by academics. While that is an easy story to tell, we suggest also considering the *commercial* side of the story. Firstly, the perception that "all is political" could underestimate Russian commercial strategies and trade-offs that could be important to understand, especially for other gas suppliers to Europe. Secondly, it may well be an advantage for Europe to portray gas as less reliable in its efforts to go fossil free, and it may be an advantage for the USA, both commercially and politically to export more LNG to Europe.
In conclusion, we see evidence of gas being used politically to connect with new "friends", but not purely politically-motivated punishments with the possible exception of Ukraine. There is clearly a grey area, with both commercial and political elements. This makes it possible to tell many different stories. Further, the lack of communication from the gas industry is making this more complex and more politicians seem to be guessing or using events to confirm their fears. However, the status today, with sanctions and escalation in propaganda, on both sides, *political pressure* on Gazprom is more likely than earlier. The political regime in Russia has changed modus and now appears less predictable, which may impact gas policies and instructions to Gazprom.

Will there be less gas from Russia in the future?

We expect EU gas demand to further decrease, so all gas supplies will probably fall. The market shares of the large suppliers, Russia, Norway, UK/Netherlands and LNG could be impacted by political preferences, but prices and existing contracts will also be important factors. Russian market shares have already decreased in some Eastern European countries and Ukraine.