

EU to
Russia

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EU to Russia

Fellow or serf?

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The purpose of this presentation

Determining relationship between two independent states, or, as in our presentation, between two aspiring ¹ global powers is very difficult. Without any thorough observation, we could simply say:

- Russia has nuclear weapons
- Russia controls primary commodities
- Russian government has limited problems with elections

On contrary,

- EU is all about democratic elections
- EU has limited natural resources
- The will of EU politicians to use force (yet - any - weapons) is almost nonexistent and US has enough problems elsewhere

Hence, European Union is just a Putin's puppet.

Is that so?

We decided to analyze the situation based on current issue - energy dependence, specifically, natural gas and it's impact as a method of political (and economical) pressure.

¹Aspiring because Russia is somewhere between "Upper Volta with rockets" and "Saudi Arabia with rockets" and European Union is far from a political union, but yet by common history, institutions and interests very far from being just a "bunch" of separate states

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Terminology

Throughout the presentation, we use Ukraine (or Russia) as “personifications” for the country, its government and those responsible for strategic industries (whoever they are). We believe (and later shall describe why) that such simplification is correct. For now, consider even in most democratic countries, owners of strategic industries (such as gas, oil, etc.) are never completely free to completely practice their rights (e.g. shut down the whole business), there is always some balance on the line between the real owner and the government, providing a lot of potential for negotiations.

How much gas does the EU produce?

- The annual production of natural gas is: 181 million tons (2005 data)
- The annual consumption is: 257 million tons (2005 data)

How much gas does Russia import into the EU?

- 2006 - 110 million tons

Gas consumption - the map

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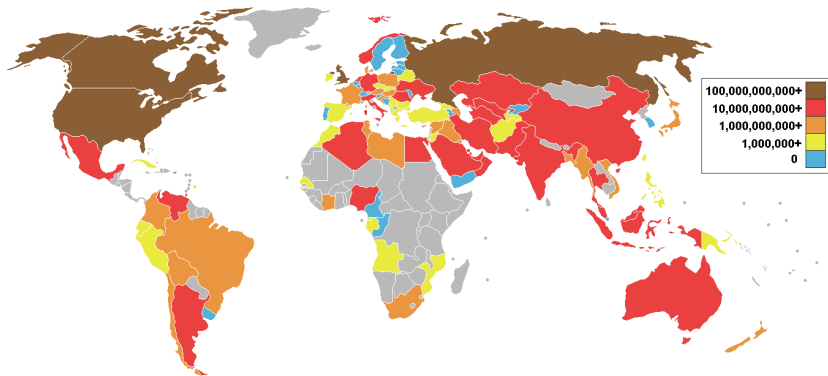
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Source: http://upload.wikimedia.org/wikipedia/commons/1/1b/Natural_gas_production_world.PNG

Gas pipeline from Russia to Europe



Source: [3]

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Who has the power?

- In many sources we can find Kremlin standing against the power of oligarchy. This can be demonstrated on the arresting of Mikhail Chodorkovskij, who was sent to prison for nine years for alleged tax evasion.
- We have reasons to believe that there exists a strong power-sharing connection between these two wings, which is maintained especially by a strong and purposeful use of intimidation.

The history of the relationship

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Significant moments of the mutual cooperation and competition

- 1991 - The Cold war ends. The Soviet Union dissolves into a great number of countries, many of them are later trying to become members of the EU.
- 1995 - Russian president, Boris Yeltsin has pronounced his affirmative opinion on accepting the three middle Europe nations (Czech Republic, Poland, Hungary).
- 1997 - Russian Gazprom and Finnish Neste formed a joint company North Transgas with the purpose of creating a gas pipeline from Russia to northern Germany across the Baltic sea. The estimated project cost is around 13-15 bil. EUR.
- 2006 - The gas pipelines to Ukraine were shut by Russia due to political reasons.

Main export partners

- Germany, Netherlands, Turkey, Italy, China, Ukraine, United States

Main export commodities

- natural gas, petroleum, wood products, chemicals, weaponry

Example

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The whole problem and fragility of resource imports to European Union have been clearly disguised during so called “2006 gas crisis”, which serves us as an example of bargaining powers of both countries.

Prelude

- Ukraine is extremely dependent on Russian gas imports (boost for ineffective economy - “ the most energy-intensive economy in the world” [4, Page 11]).
- Ukraine, as a part of ex-Soviet Union, received gas for special prices (around 15 % of transferred volume for servicing the pipeline - which proved to be quite unserviced - and allowed to buy extra gas if needed).
- European price level in 2005: \$160–230 per bcm; Ukraine's price level: \$50 per bcm²
- Orange revolution (December 2004; large movement against current government and Yanukovich/Kucma, however, not a “pro-western” movement, as implicated in the western media). Over the next year, relations with Russia totally deteriorated.

Ukraine's energy sector

- Share of gas on total primary energy supply: 47 % (Source: IEA, Ukraine Energy Policy Review, 2006, pp. 75-77)
- Gas prices for industry and households bellow price of delivery - a method of sustaining calm situation in a desperate country.

²N.b.: the price was actually near market price at the beginning of nineties, it just hadn't been adjusted.

The problem

- Since the dissolution of the Soviet Union, Ukraine had problems with payment for gas (even for low prices).
- From time to time, Ukraine would withhold some of the gas transported to the “West” .
- Before January 2006, three months of unsuccessful bargaining of new prices had passed.
- Russia (Gazprom) demands higher prices (the original bargain: 100 - 180 USD per bcm); Ukraine cannot afford price increase politically nor economically.
- Russia sees no purpose in supporting (subsidizing) a country flirting with the “West” (as in NATO, EU, etc.)

The story

- Gazprom demands “political” price of 230 USD per bcm (“Western border price”), and stops any gas shipments to Ukraine.
- “Western” (EU) countries observe sudden drop in gas shipment.
- Sudden crisis - gas reserves are limited³.

³Note: we did try to find gas reserves per country in the European Union, however, we did not come across reasonable data.

The result

- European Union did not take unanimous action, and thus proved that its unity is far from complete.
- Russia did not take any action that could spoil, or suggest spoiling peace in Europe (contrary to popular belief that it would - of course, omitting smaller countries and Russian “dominions”).
- The whole problem was solved with a rather nice agreement - Ukraine will buy Turkmen gas at slightly higher prices (which should at some point converge to market price) and Russian gas at market price, while Gazprom will pay for transit of gas⁴

⁴For the whole agreement, see [5], page 9

Prices for natural gas delivered to European consumers, 2006 (including VAT)

Residential customers	USD per bcm
Ukraine, inc. Turkmen gas	36.6
Russia	44.8
Moldova	118.0
Poland	460.0
Germany	478.7
Average for EU	523.4

Industrial customers	USD per bcm
Ukraine, inc. Turkmen gas	141.6
Russia	61.7
Moldova	118.7
Poland	237.4
Germany	420.0
Average for EU	430.0

Source: Energy Strategy, 2006, p. 75; Eurostat (for EU) and official statistics (for CIS).

Who needs whom, anyway?

From our humble collection of facts, we believe that the relationship of Russian Federation and European Union is a partnership, rather than an asymmetric. Russia (and Gazprom) has imminent interest in continuous, secure shipment of gas to Europe, as it is a considerable source of income. European Union has imminent interest in sustaining Russia as a stable trading partner (because unstable Russian Federation always means problems).

We can safely conclude that Russia is unlikely to use energy resources to produce political pressure on countries of European Union as a whole, as long as EU continues remain to be able to pay for all the imports. However, there is a significant risk from unstable regimes (like Ukraine), which can stop transfers of e.g. gas, and specifically, prohibit it for prolonged periods of time (no matter what the costs might be, with full knowledge that any intervention by force would be too expensive and politically unfeasible).

Currently, such risks are being avoided by creating other pipelines. Fortunately, even without such pipelines, no country has ultimate bargaining power, as was proved during the 2006 gas crisis, where all three sides found an agreeable solution (albeit with some fear spread by journalists).

For Further Reading I

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STERN, Jonathan P.

The Future of Russian Gas and Gazprom

Oxford Institute for Energy Studies, Oxford University Press, 2005



CIA Fact Book

Gas consumption map [http:](http://www.cia.gov/cia/publications/factbook/rankorder/2180rank.html)

[//www.cia.gov/cia/publications/factbook/rankorder/2180rank.html](http://www.cia.gov/cia/publications/factbook/rankorder/2180rank.html)



Energy Information Administration, U.S. Department of Energy

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<http://www.eia.doe.gov/emeu/cabs/Ukraine/NaturalGas.html>



Oxford Institute for Energy studies

PARIANI, Simon: Ukraine's gas sector, 2007

<http://www.oxfordenergy.org/pdfs/NG21.pdf>



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STERN, Jonathan: The Russian-Ukrainian gas crisis of January 2006

http://www.oxfordenergy.org/pdfs/comment_0106.pdf



Eurostat

http://epp.eurostat.ec.europa.eu/pls/portal/docs/PAGE/PGP_PRD_CAT_PREREL/PGE_CAT_PREREL_YEAR_2008/PGE_CAT_PREREL_YEAR_2008_MONTH_07/8-10072008-EN-AP.PDF