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**Russia and the Security of Europe's
Energy Supplies: Security in Diversity?**

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Key Points

- * Russia has become the gravitational focus of European energy security thinking. The focus is on Russia's political unreliability, Moscow's support for energy monopolies and the sustainability of Russia's reserves. This latter point is the key, and there are justifiable concerns about how Moscow will meet both increasing domestic demand and foreign contracts.
- * Russia poses a complex series of questions. The renationalising of its energy sector makes the sector murkier and less transparent than a "western" style renationalisation process would. Moreover there is infighting between vested interests in the Russian energy sector. So, though Russia may have a political idea about its energy status as a world power, there is no coherent energy strategy driving policy.
- * Diversity is usually posited as an answer to the problems posed by Russia. However the options are often problematic or do not represent real diversity.
- * Most thinking in Europe is reactive rather than active. Europe should be focusing on its own domestic capabilities and developing a coherent strategy linking domestic and external strands.
- * This has long been realised, yet converting it into practice is difficult because of the various agenda within the EU. Europe already has diversity in energy type, source and transit route – with the result that consensus is difficult to achieve. Lack of consensus gives Moscow much more room for manoeuvre in negotiations.
- * Enhancing the EU's energy security begins within Europe, but also requires coherent engagement with third parties – including Russia – to develop partnerships to ensure security all along the energy chain.

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The EU and Russia: The Evolving Energy Security Picture

An evolution is taking place in the discussion about the security of European energy supplies. Concerns about Russia using its energy reserves as a lever to undermine European diplomacy – or even as a tool to blackmail the EU – were prominent in the second half of 2005 and early 2006. During the UK presidency of the European Council, Europe's 'dependence' on Russian oil was a major issue; in early 2006 it was Europe's dependence on Russian gas – highlighted by high-profile focus on Russia's cut offs of gas to Ukraine in January and February which had a practically brief and small effect on the supplies of some member states but a politically dramatic and prolonged knock-on effect on confidence in the EU as a whole in Russia's reliability as a supplier.¹ The dispute between Russia and Belarus has again brought such concerns to the fore. Thus a tension has emerged between slow improvements in the bureaucratic side of the EU-Russia energy dialogue, most clearly represented during the EU Permanent Partnership Council meeting on energy during the UK Presidency, and the fast deterioration of political confidence in the energy partnership in both the EU and Russia.

As spring flowered, the focus of attention in EU policy-making circles and some national capitals, especially amongst the EU's 'older members', began to shift away from Russia using its energy reserves as a lever against the EU. This was recognition of the point that the EU market sustains Russian energy exports – which provide the foundation of Russia's economy. President of the European Commission Jose Manuel Barroso illustrated this recognition of interdependence: consumers need the supplier, but the supplier also needs the consumers, he noted at the EU-Russia summit in May.² This created a mutual interdependence which provided a defence against Russian 'leverage' over the EU.

Furthermore, greater complexity has been evident in official EU discussion about Russia and the security of energy supplies in two ways. First, there is recognition that the sustainability of Russia's resources is questionable: despite its huge reserves, Russia may not be able to meet the EU's demands, particularly in gas supply. Christian Cleutin, Director of the EU-Russia Energy Dialogue, has estimated that by 2020, the EU's gas requirements will rise by some 200 million metric tons of gas per year, but that Russia planned to expand its production by just 50 million metric tons per year by then and that this increase is not just for the EU but other third parties also.³ Barroso also noted that in the 'future the gap between supply and demand could become a serious problem'.⁴

Much of Russian oil and gas production is from a small number of very large but mature fields, and there has been little investment in the infrastructure or

development of new 'green' fields. Russian officials, former officials and experts have repeatedly stated their concerns about the sustainability of Russia's reserves and the need for investment in developing them. Vladimir Milov, President of the Institute for Energy Policy in Moscow, points to an investment crisis especially in Russian gas. He notes that during the last 15 years Gazprom has done little to develop new fields, meaning that new fields are not likely to come on line before 2015. German Gref, Russia's Economic Development and Trade Minister, also recently stated that Russia may face a crisis because of a shortage of natural gas in the near future, noting the pressure which the energy system came under during the cold snap in Russia during the winter 2005-6. Last winter gas shortages obliged Mosenergo, the Moscow heating utility, to cut supplies to some industrial consumers to maintain supplies for domestic heating.⁵

Russia has so far endured a very mild winter this year, but the point remains valid both for the remainder of this winter and next winter, particularly because of the potential impact of such shortages on the results of the Parliamentary and Presidential elections looming (2007 and 2008 respectively). A key problem is therefore how Russia handles its growing domestic energy consumption relative to its finite production capabilities and export commitments. The potential political significance of a choice for Moscow between supplying Russia's domestic market or a foreign export one in case of shortage during a cold snap is an increasingly important focus, one grasped by only a small number of specialists both in Brussels and some national capitals.

Second, there is greater recognition of the fact that relations with third parties have important roles, as transit states are also part of the security of energy supplies equation, rather than it simply being a producer/consumer relationship. This is particularly important for the EU, since most of its energy imports from Russia come via Ukraine and Belarus, two states with uncertain relations with Russia. Partly in response to the predicament caused by this, the EU has sought to develop relations with Ukraine to enhance transparency of gas flows. The EU negotiated with both Russia and Belarus over the disruption of oil supplies to Europe following the mutual tax increase imposed by Moscow on oil exports to Belarus and by Belarus on Russian oil transiting Belarus, and the subsequent reduction of oil flows for three days from 6 January. Russia refused to pay the tax and supplies were disrupted by Belneftekhim, the Belarus state energy monopoly and then Transneft, which accused Belarus of siphoning off oil meant for Western Europe and so stopped supply. Oil supplies to Poland, Germany and the Czech Republic were affected, but the EU and International Energy Agency (IEA) both stated that there would be no major disruption to consumers, since there are sufficient reserves.⁶ Far less prominent has been a similar problem between Russia and Azerbaijan. In response to increased gas prices being imposed on Azerbaijan by Gazprom, Baku halted imports of Russian gas and exports of Azeri oil via Russia to Europe from 1 January (in 2006, Baku exported some 1.2 million tons of oil via the pipeline from Baku to the Russian port of Novorossiisk).⁷

The political impact of Russia's cut off to Ukraine (and Georgia) during the winter 2005-6 has not disappeared however, and therefore Russia's political (un)reliability has remained a constant focus for some EU governments. For many, it has simply been emphasised by the disagreement between Russia and Belarus. Governments of new member states in Eastern and Central Europe have viewed Gazprom's policies as a security threat (importantly, given its support for these governments, the USA shares similar concerns). Such views also resonate in the media throughout Europe more broadly, helping to keep this particular understanding of

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the problem politically prominent, even in states which do not import significant quantities of Russian energy. The Baltic Sea Pipeline being constructed to link Russia directly to its market in Germany, avoiding transit routes through Poland, is a key focus of concern for some. Indeed, the political sensitivity to this in Poland is reflected by Warsaw's claim that the deal represents a new Molotov-Ribbentrop pact. It is hard to imagine a more evocative image drawn from Europe's recent past as a harbinger of coming disaster for European stability and security.

Moreover, if the root problem remains the actual sustainability of Russia's reserves and the need to invest in Russia to enhance it, the focus too often transforms into a 'values' clash between the 'liberal' EU consumer market opposed to the 'monopolistic' Russian producer which focuses more on political control than mutually beneficial profit. Although questions may be asked about the progress of the liberalisation of the EU market, this transformation in the debate both fits with what some commentators argue should be a key element of the EU's negotiating with Russia in its broader relationship – the re-assertion of 'common values' in the relationship – and of course has merit in its own right as an apparently logical step from the concerns about lack of investment in future capability.

The main points are first that Russian state-run companies are inefficient at exploiting current projects and too debt ridden to develop new ones; second, that the state (or, more accurately, interests linked with those who are currently state officials) controls ever larger sections of the Russian hydrocarbon production sector; and third that western companies are more efficient and better equipped both with expertise and technology to develop the hard to reach green fields. Finally, the 'monopolistic' approach in Russia undermines both creative and beneficial competition among Russian firms and the ability of Western companies to become involved effectively, as Western companies increasingly face the same concerns as Russian ones. These include unstable property legislation, vulnerability to political pressure in the shape of tax claims and uncertain licensing conditions. Three examples stand out: Gazprom's eventual rejection of foreign assistance in developing the Shtokman field, Gazprom's acquisition of a majority holding in the Sakhalin II project (simplistically considered to be 'Yukos revisited') and pressure on TNK-BP.

A difference in approach between Russia and the EU is clear. But the central problem – the sustainability of Russian reserves and most particularly what this means for the EU in the narrow focus (increasing imports of Russian gas, particularly in Germany) and in the wider context, for instance increasing Russian domestic consumption and electricity production capabilities, is too often in the background or even overlooked completely.

This paper seeks to establish a more strategic horizon for understanding Europe's security of energy supply in relation to Russia. It briefly examines the nature of the problems posed by Russia before turning to assess some of the EU's responses. The focus of the paper is on the call for greater diversity, particularly away from Russia. The paper tries to distinguish between a complex diversity of energy type, source and transit route, which is of course an important element of energy security – but one which poses its own problems - and these calls for further diversification.

At the outset, it should be noted that in many cases, the paper refers only in brief to issues which deserve much more detailed examination, since they are complex matters in their own right. It is to be hoped that such issues can be covered in more

depth in subsequent research. The point is to begin to place Russia in an appropriate strategic context and link a wider range of questions to highlight the tension between the difficulties posed by Russia (and some ongoing misperceptions about them) and the difficulties potentially created by some of the responses so far. To reiterate: diversity is of course good and necessary for energy security – but it is not the solution in itself. It is simply one part of an ongoing dynamic response. Russia indeed poses serious questions and problems for the security of Europe's energy supply, but solutions to them lie in engagement, not further diversity. Engagement will not be easy – indeed it will be a long and arduous task with setbacks. But alternatives, as this paper illustrates, do not offer any easier fix.

Russia as 'the Problem'

Russia has become the gravitational focus for many of the anxieties about the security of energy supply in Europe. Widely considered an unreliable energy superpower from which Europe will have to import increasing amounts of energy, particularly gas, Russia poses what is in essence a three-pronged problem: its political reliability, a contrasting political-economic approach and questionable the sustainability of its reserves.

Yet too easily have commentators and politicians fallen into received knowledge about Russia – the 're-nationalisation' of the energy sector, the reconstruction of the vertical of power in decision-making and the development of an energy strategy to reassert Russian influence as an energy superpower particularly in the former Soviet Union to name just three. Though there is often some substance to these points, focusing in this way on Russia at once blinds us to the intricacies of the problems posed by and in Russia and blinkers us to the many other issues relevant to the security of Europe's energy supplies both domestically and in the wider global context. As noted in the next section, it has rendered EU thinking reactive when it should be active. And the reactions are themselves potentially undermining the security of Europe's supply.

While this is not the place to address these three key questions about Russia in detail – and others besides – they warrant brief assessment to underscore the complexity of the questions Russia poses for the security of Europe's energy supplies. The three points are interlinked. First, there is not a 're-nationalisation' of the Russian energy sector in the manner that is usually understood in the West – it is more what Milov has called a 'shady nationalisation'. If there is indeed creeping control of private companies in the oil sector – and it should not be forgotten that the state pipeline monopoly Transneft controls the flows of oil – for the time being the majority of crude oil production remains in private hands. State companies represent some 27% of crude oil output, with a further 16% of the sector in a 'grey zone' of being controlled by state companies (but not themselves being state companies) and 57% being represented by private companies. Milov notes the temporary pause in the growth of state control, but suggests that there could be a further blurring of the distinction between state companies and 'grey zone' companies and a growth of this sector to dominate some 65% of the structure of Russian crude oil output.⁸

Gazprom of course dominates the Russian gas sector. However, it is important to remember the existence of independent companies, since these are beginning to assume an important production role that is not commensurate with their comparative power. In early 2006 there were 30 independent companies producing

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over 10 million cubic metres per annum. Independents hold licences for nearly 20-25% of Russia's explored free gas reserves, some 11 trillion cubic metres of gas. While Gazprom's production stagnates, these independent gas producers have sufficient potential to increase production – indeed during the period 1999-2005, they doubled their share of total gas production from 6.4% to 13.6% and sold 74 billion cubic metres of gas to the Russian domestic market in 2005. Some estimates now put their share at some 20% of the domestic gas sales in Russia.⁹

Though the numbers are not large, this should be seen in relation to Gazprom, which has struggled to maintain production.¹⁰ There are a number of scenarios about Gazprom's situation and prospects currently being proffered by experts along a scale of at one end a successful and sustainable development of reserves – a view espoused by Gazprom itself, of course – and at the other what amounts to a gas crisis for Gazprom beginning as early as 2010.¹¹ Most western and many Russian experts tend towards the middle or latter end of the scale, even if they do not concur that a crisis is imminent.

The independents are therefore important, particularly given the concerns noted above about Russia needing to meet a growing domestic demand (some 6-7% according to Gref) while also honouring its export contracts. Nonetheless two points bear highlighting about the independents. First, they face pressure from Gazprom, including hostile takeovers (such as that of Northgas in 2005) and very unfavourable operating conditions, including restrictions on access to export facilities and governmental regulation of gas prices. Indeed, when considering these companies to be "independent", it is important to remember Transgas and Gazprom's hold over the pipeline system – which immediately places a constraint on their independence of action. Second, 'independent' here means 'not Gazprom' – the state oil company Rosneft, for instance, is one of the leading producers of gas, and is considered an 'independent'.¹²

Moreover, growing state influence in the energy sector does not mean, as some suggest, a 'renationalisation' process. Simply because there are representatives of the state on a company's board does not mean that it is "renationalised". Renationalisation would suggest that they have become the public property of Russia. The situation is murkier and is closer to 'shady nationalisation'. Milov argues that these assets are no closer to being public property than before and are in fact *less* transparent than if they were nationalised. He notes, for instance, that the state's first action following the resumption of its control at Gazprom was to remove the review of its annual investment programme from the agenda of the Russian government. It will be reviewed now by the board of directors of Gazprom, the majority of whom are not government officials. Milov also notes that control of the assets acquired is usually by daughter and grand-daughter companies (Sibneft was not bought by Gazprom but by Gazprom Finance B.V., which is registered in the Netherlands). Therefore he states that

if with the companies controlled (100%) by the state directly ... members of the board of directors have some special formal relations with the state and bear some obligations in terms of efficient use of public assets, to various daughter and grand-daughter companies such procedures and requirements for public control simply do not apply.¹³

Second, there has indeed been a reconstruction of a power vertical during President Putin's two terms in office. Initially necessary, given the parlous state of the

Federation, this has increasingly posed difficulties in the decision-making chain, most particularly over-reliance on one office (the Presidential Administration) and indeed one person, the President himself. Moreover, this power vertical has another in-built weakness that looms large with the parliamentary and presidential elections in 2007 and 2008 respectively. It appears that the vertical is under pressure as there is a power struggle taking place within it. This was exemplified in the confused and confusing developments in the lead up to the transfer of majority control of the Sakhalin II project to Gazprom, when different ministries espoused different positions about the continued licensing of the project.

Third, and following on from these points, if there is a political *idea* for Russia to use its energy resources to 'recapture its greatness' on the world stage, there does not seem to be an actual coherent *strategy* behind this, in the sense of who is to achieve what specific aims, with what resources and in what timeframe. The Russian energy strategy encapsulated in the document 'The Russian Energy Strategy to 2020' approved in May 2003 is in the best traditions of such a document, being indistinct and allowing significant room for manoeuvre. The International Energy Agency, for instance, considered it to be vague about the role of Gazprom and Russia's approach to the Kyoto agreements.¹⁴

The ongoing domestic conflicts themselves undermine the establishment of a coherent strategy. The events noted above relating to Sakhalin II illustrate the conflicting aims between interests in Russia. Moreover, it is a strange strategy that seeks to establish two national hydrocarbon champions, Gazprom and Rosneft – particularly given that they compete – and groom a third in Alrosa. Other examples of the lack of coherence in Russian 'strategic' energy planning include the debate over whether to maximise immediate hydrocarbon production and export or to slow production down to prolong production levels; and the conflict over the plan to switch from gas to coal to power domestic industry and electricity production.

In terms of a foreign energy strategy, even if there are concerns about Russian actions in the former Soviet state – and this is a more complex situation than many allow – Russian officials frequently reiterate the importance of the European energy market for Russia. However, there is confusion over how to diversify exports. The attempts to develop a relationship with the USA remain essentially hollow and have been dealt a major blow by the decision to dedicate the Shtokman field to Europe. Exports to China have grown of late and plans exist to increase these exports to meet the potentially huge Chinese market. Gazprom has already begun pipeline construction.

Yet the plan to diversify to the East advocated by some in Russia is as confused – for example whether to focus on China or Japan – as it is problematic. Some Russian experts argue that Russia must diversify towards the East, since by tying itself to partnership with Europe, it ties itself to a partner with very low growth rates. Its energy engagement with Europe also does not open up European markets to other Russian goods. The consequence will be that Russian growth is also limited, argue those such as Mikhail Dmitriev, President of the Centre for Strategic Research.¹⁵ Others argue that Russia should use the potential for re-orientation of its energy supplies to more cooperative clients, including China, as a bargaining chip with Western consumers.¹⁶

Yet China is not an optimum market for Russia, not least because it pays less for hydrocarbons than the EU. If Chinese dominance of Russia's eastern exports is difficult in Moscow because of the added influence it would give to China politically

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and economically, it is also questionable in terms of sustainability, since Chinese gas consumption fluctuates and may fall as it seeks to reduce its own dependence on imported energy by increasing use of its large domestic coal reserves.¹⁷ (It is worth noting that others in the west also are questioning the 'China myth' which argues that the growing Chinese economy will absorb ever greater quantities of oil: it still imports only a small amount of the world total; the huge increases in 2003 and 2004 were inflated because they represented a rebound from earlier stagnation – and the increase in energy consumption was greatly assisted by local subsidies and price controls, some argue. If in 2004 Chinese oil consumption increased by 16%, in 2005 this fell to 1.5% and 2006 figures suggest growth of 6.1%. Moreover, the Chinese government has announced plans to end or diminish subsidies. If such arguments carry weight, they do not bode well for Russian diversification efforts to a Chinese market.)¹⁸

An interesting argument made by some western and Russian commentators links all three points: Russian 'strategy' is being directed by short-term interests in what amounts to an asset and wealth grab before the change in leadership in 2008. This is a key point for western strategists to consider for three reasons. First, it illustrates the point that personal profit, not political agenda, will dominate Russia's energy relations with the EU in the short term – and if the elite seeks wealth, it needs the EU market. Second, it highlights the need to think flexibly, constructively and coherently about the political situation in Russia between now and 2012. Finally, it throws the sustainability problem into its clearest relief, even to those who are not convinced by the 'train wreck in progress' analysis of Gazprom's decreasing capabilities. If the Russian leadership is only thinking until 2008 and seeking to maximise immediate profit rather than invest for the long term, this has significant ramifications for the short-to-medium term production capabilities.

EU Responses – Security in Diversity?

Apart from trying to develop the EU-Russia energy dialogue, there have been four key responses by the EU and its member states to the complex strategic questions posed by Russia. First, the EU has sought to persuade Russia to ratify the Energy Charter Treaty (ECT), particularly the transit protocol. Second, some have argued for involving the North Atlantic Treaty Organisation (NATO) in the debate about the security of energy supplies. A third response, most clearly illustrated by the Poles at the recent EU-Russia summit in Helsinki, has been to use a veto to block dialogue. The fourth is the most often heard reaction – the call to diversify away from Russia, again reiterated following the disruption to Russian oil transiting Belarus in January.

All four of these responses have proven or are likely to be problematic. Repeated efforts to persuade Russia to ratify the ECT have run into repeated Russian rejections, most recently reiterated by President Putin at the Helsinki EU-Russia summit in November 2006. The use of the veto, blocking progress in negotiations, and the introduction of NATO into the energy security debate raise questions about the cohesion of the EU and the coherent evolution of NATO's agenda. Sustainable arguments for NATO to adopt a role in global energy security exist, though consensus among members on this issue has not been easy to achieve. Moreover, calls for it to have a more regional focus on using its diplomatic weight to influence Russian decisions are likely to raise concerns in Russia about the planned utility of

a military alliance in what is widely considered an economic issue and undermine political confidence further. This would have to be a very carefully managed role to avoid further decreasing confidence and even destabilising the security of Europe's energy supplies.¹⁹

But it is the drive for diversity which may undermine EU energy security more completely. Such an argument appears to run counter to almost all wisdom – the vast majority of analyses cite or reflect Churchill's dictum about safety lying in variety. And of course, diversity in energy security is indispensable. There should indeed be a diverse range of sources, transit routes and energy types. Moreover, Russia seems to pose so many complex problems, in terms of its domestic political and energy production, its influence over other producers and transit routes and of course the growing concerns that it may seek to use its energy power for political influence further afield, that it appears logical to seek other sources.

Nonetheless, several points must be considered. First, the EU already has this diverse range of energy type, energy sources and transit routes. In terms of energy type, oil accounts for some 37% of EU energy consumption, natural gas 24%, solid fuels (including coal, lignite and peat) 18%, nuclear power 15% and renewables 6%.²⁰ This does not clearly reflect the key importance of oil to the European energy mix, but it does reflect the roles other energy types play. It should also be noted that liquefied and natural gas (LNG) will increase in importance in the mix.²¹ In terms of sources, Russia looms large – and rightly so, since it is an important supplier both globally and to Europe more specifically. But it is the Middle East that provides the bulk of Europe's oil. Other regions and states, including Russia, Latin America and Northern and Western Africa provide diversification. As for gas, a more regional energy type, Russia is a major supplier, linked to the European market by a dense network of pipelines. But 'EU' Europe also has other important gas suppliers including North Africa, the Middle East, Latin America and Norway which currently supplies a large amount of gas to the EU and which also has significant undeveloped reserves in the Barents Sea. Currently Norway meets approximately a quarter of the gas needs of the UK, France and Germany; by 2011 Norway seeks to supply Europe with 135 billion cubic metres of gas per year and Norwegian exports to Europe are predicted to increase by some 50% during the next 15 years.²² These sources are maintained by numerous routes and other routes are being prepared. Of course, this diversity can and indeed should be enhanced. But how?

This diversity itself creates a number of problems, particularly since energy security is often viewed as a national concern, rather than an institutional one. If the need for greater coherence on these issues is recognised in some national governments, converting this into practical reality at the EU level remains elusive. Paradoxically, if the EU was *less* diverse than it currently is, it might be easier to create a unified strategy: at present, the agenda of each state varies significantly. If it is true that the EU's new members – but also increasingly Germany – rely heavily on Russia as a supplier, many of the older members, particularly in western Europe, do not, importing instead from Latin America, North Africa or the Middle East or because other energy types, such as nuclear, feature more prominently in their energy mix.

Some states, import a larger percentage of their oil supplies from Russia. These include Hungary (84%), Slovakia (82%) and Poland (77%). However, other states import much less oil from Russia – Germany imports 26%, Italy 18%, France 11% and Denmark 2%.²³ There is also disagreement about the roles of nuclear renewables as alternatives. Nuclear energy is a highly contentious issue in

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European politics. Currently renewables represent less than 7%, but the new EU energy package aims to increase this percentage to 20 by 2020. There is scepticism about the desire of member states to achieve this, however, and indeed about whether existing targets are being met.²⁴ Moreover, some of the older members of the EU do not fully subscribe to the more robust political line towards Russia being proposed by the new members. This significantly hinders the formulation of a coherent policy towards Russia – some states view Russia and its energy 'policy' as a major threat to state security, while others view it as a viable alternative to other sources for specific types of energy.

Therefore, when a 'threat' emerges, such as that posed by Russia, the question arises of 'what threat and to whom?' and the alternative remedies are viewed very differently. Simply, if the Poles view Russia as posing a significant threat to Europe's energy security, few others see it to be so extreme, and some do not see the threat at all. One illustration of these points and the difficulties of the current diversity was Italy's move to acquire more Russian gas – a move that was widely viewed (and with some justification) as Rome placing Italy's national interests ahead of those of the EU and further undermining EU energy security by increasing its imports of Russian gas. Yet Italy's actions were also partly motivated by concerns about the reliability of its other suppliers in North Africa. It is widely recognised, and frequently reiterated, that the EU needs a more coherent and unified stance in negotiations with Russia, since Russia is currently able to use the fragmented positions of the EU to develop bilateral deals and undermine the coherence of the EU's position further. This, however, is proving much more difficult to achieve in practice.

The second key point about diversity is that current calls simply seek diversification away from Russia, essentially in reaction to it. This raises problems for Europe's energy security in the strategic perspective. It undermines what has essentially been a mutually beneficial relationship between Russia as the 'producer' and the EU as the 'consumer'. The point that Russia has been a reliable supplier to the EU even during the Cold War and periods of great domestic difficulty for Russia bears repeating – it is a point again stressed by Barroso during the EU-Russia summit in May 2006, for instance.²⁵ Of course, previous experience does not mean that it will necessarily remain so in the future, but, as noted above, Russia currently and for the foreseeable future has a vested interest in maintaining a strong relationship with the EU which is its major energy market, indeed the market which sustains the growth of the Russian economy.

These signals being emitted by its major market about the need for diversity away from it are received in Russia and undermine confidence in the relationship. Two reactions result. First, by stating a desire to diversify away from a particular source, the EU undermines confidence among those who seek to develop resources there: why develop them if the major market will not be buying them? (Commentators have made a similar point with regard to the relationship between US and its oil suppliers in the Middle East – following President Bush's statements that the US needed to wean itself off its oil addiction, there was concern that this would undermine the prospects for necessary investment in the energy infrastructure and exploration in the Middle East).

Furthermore, this means that Russia also must diversify away from the EU market in order to sustain its economy. This creates an energy security dilemma, where confidence in the relationship is undermined by repeated assertions by both sides

to find other partners with the illusion of enhancing their stability, but in fact generating the conditions for instability. This was a noticeable feature of the debate in 2006, when Russia began to advocate developing other markets in response to EU statements about diversifying its sources, causing a further reaction from some quarters in the EU.²⁶

This means that Russian resources for developing green field sites, particularly those in eastern Siberia, may go into creating infrastructure to supply other markets rather than Europe. It also means that essentially finite Russian resources will be divided further between Europe, the Russian domestic market and other markets such as China and India. Russia of course has every right to diversify its markets for its own security. However, these other markets, as noted above, are deceptive and hold limited value for Russia for both financial and political reasons. Diversifying to them may have negative consequences for Russia, particularly slowing economic growth – a point which will have implications for the EU.

Diversifying away from Russia will therefore alter the strategic horizon. One illustration of this is the impact that it would have on the Russian economy and the ripples this would create. Despite some diversification within the Russian economy, it still remains dependent on its energy exports to the EU to sustain its growth. Without this pillar, there is every reason to suppose that the Russian economy will stagnate – or worse, deteriorate. This would have two potential knock on effects. First, it would alter the political situation in Russia significantly, creating instability, generating either a reaction from the government or maybe even a change in government.

Furthermore, there would be a ripple effect throughout the former soviet space. Russia is an economic focal point among the newly independent states. Economic stagnation or collapse in Russia would have a significant impact on those who have migrated to Russia to seek employment and send their earnings home. Money earned in Russia is a significant factor in the growth of the economies of Georgia, Armenia and Azerbaijan, for instance. Undermining this could affect the economic and political stability of these three states, and others. A worst case scenario might therefore see economic collapse and political instability in Russia, the newly independent states – in which the EU hopes to develop alternative sources and transit routes – creating a more complex situation for the EU in its new neighbourhood.

The third key question is about the potential new sources of energy – and what the likely benefit would be. The call to diversify away from Russia is too rarely supported by related suggestions for alternative suppliers, but this of course is the key: few of the alternatives for either oil or gas offer more stable or reliable or sustainable resources than Russia. Some potential alternatives, such as Trinidad and Tobago, do not offer a serious, substantial alternative for the long term. Latin American states such as Bolivia and Venezuela clearly pose political questions. Natural resource nationalisation and the expropriation of foreign assets are on the agenda in both states (though only adopted to a small degree so far in Venezuela). One commentator has noted that in Bolivia, the government prefers nationalisation of its large gas reserves – but that this needs to be related to the need for significant investment to develop them.²⁷

Iran, a major potential alternative gas supplier, also poses problems. Though it holds the second largest gas reserves (some 16% of the world's total), and Tehran is proposing Iranian gas sales to Europe, its domestic political situation and

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international political stance are more awkward than Russia's. (More developed European energy relations with Iran may also pose problems in Europe's relations with the US,²⁸ and would also seem to run counter to Prime Minister Blair's approach to Iran). Furthermore, the extent to which its reserves are sustainable and particularly accessible is open to question – significant investment is needed in its oil and gas production capabilities.

Great store is also set by the gas reserves in Central Asia, particularly Turkmenistan, yet similar problems are evident here also – the extent of the gas reserves in Turkmenistan is particularly obscure. Moreover, some reports suggest that Turkmenistan has agreed to export contracts for 2009 that may be double what it can produce. Turkmenistan's position as a supplier in recent times has been dominated by the idiosyncrasies of its President. If some experts expect a series of reforms to be implemented following his death in December, for the time being it remains unclear how Niyazov's successor will improve both the domestic climate for investment and improvement of the energy sector, or stabilise Turkmenistan's foreign policy. Certain points are worth highlighting though. First, should there be problems in Turkmenistan, this could affect the supply of gas to Ukraine – which would then again have to rely on Gazprom. Moreover, following the death of Niyazov, some suggest that other states will seek to increase their influence in Turkmenistan – including Russia, which has a major interest in Turkmen gas to sustain its own energy strategy, the USA and China. Niyazov had been planning a gas pipeline via Afghanistan and Pakistan to India and another to China to diversify Turkmenistan's markets away from reliance on Europe.²⁹

Increasingly attention has focused on the potential of Qatar and Saudi Arabia, which are indeed superficially attractive sources. Both have significant resources (Qatar holds the third largest natural gas reserves and as one of the leading producers of LNG is seeking to triple its LNG production to 77 million tons per annum by 2010) and are not just open to supplying European markets but investing in those markets' ability to import LNG (Qatar is investing in the construction of LNG reception facilities in the UK).

This poses a strategic question, however – to what extent is this enhancing diversity? Europe already depends significantly on the Middle East for its oil; to have the Middle East also as its major gas supplier represents false diversity. Of the 17 disruptions of more than half a million barrels or more of oil in the past 30 years noted by one high profile expert, 14 were in the Middle East.³⁰ It would be right to be concerned about the stability of gas supplies also. To reiterate: it is right to be concerned about Russia's role in the supply of gas to the EU, and it seems beneficial to increase imports of LNG, particularly from producers that actively seek to develop such relations, but focusing increasingly on the Middle East for both oil and gas does not represent security in diversity. Another example of this is Algeria, which currently supplies an important part of Europe's gas. Algeria has been in negotiations with Russia about agreeing a deal to provide reciprocal supply to each other's customers – increasing imports from Algeria would also therefore not represent a move away from Russia.

Diversity in transit also needs careful consideration. Again, it makes good sense to have a variety of routes that do not depend on Russia, but this should not blind planners to the complexity of such routes and third party relations. Two linked examples illustrate this. First, there are high hopes for developing alternative transit routes via the South Caucasus, reflected in the Baku-Tbilisi-Ceyhan (BTC)

and Baku-Tbilisi-Erzurum lines for oil and gas respectively. This, in theory, provides access to both Caspian and Central Asian sources, and is one of the aims of persuading Russia to ratify the ECT and transit protocol. In fact, it underestimates the complexities of the South Caucasus and Central Asia. The South Caucasus is unstable, with three ongoing frozen conflicts. Perhaps most important for the transit issue is the conflict between Armenia and Azerbaijan: not only does the conflict have an impact on Azerbaijan's development, the BTC is not far from the ceasefire line and would be vulnerable to any resumption of hostilities. In fact, the pipelines also run through Georgia, and would be disrupted by any resumption of conflicts there also.

Apart from the ongoing conflicts in the region, there are complex domestic situations in Georgia, Armenia and Azerbaijan and intricate and multifaceted interrelationships between them. The influence of neighbours such as Russia, Iran, Turkey and Turkmenistan is also important. This is not the place to examine these intricacies, suffice it to note two examples of how this affects transit via the region. First, Russia has exerted pressure on Armenia to reject Iranian efforts to transit gas through Armenian territory. Second, it is not simply a question of avoiding Russian influence – during his time in office, President Niyazov refused to export Turkmen gas via Azerbaijan, viewing Azerbaijan as a competitor. Indeed in 2001, a serious pipeline project which would have sent its gas to Turkey via Azerbaijan was rejected by Turkmenistan, effectively suspending the possibility of significant Turkmen gas exports to Europe.³¹ This left him with little option but to export via Russia. It remains to be seen how Turkmen-Azeri relations will evolve under the guidance of a new leadership.

Ankara's efforts to establish Turkey as the fourth main artery of Europe's energy security are the second main illustration. Obviously an important part of the efforts to develop the Caspian and Central Asian energy reserves, Turkey apparently represents greater diversity of transit routes, a view that has perhaps in the past been polished by the fact that Gazprom has tended to see Turkey as a competitor, notwithstanding the existence of the Blue Stream pipeline under the Black Sea which opened in 2002. This plan to develop Turkey as an alternative route is clearly represented also by the Nabucco pipeline project which will originate near Turkey's eastern border and will open a corridor for Caspian and Middle Eastern gas into the EU. Officially, the project is considered to be 'one of the most important European Energy Projects, which allows the EU to diversify its transport routes and gas supplier countries'.³²

Apart from the questions raised above about the stability of the South Caucasus and the sustainability of Caspian and Central Asian gas, there are two problems with this. First, Gazprom has sought to block competition with plans to increase gas deliveries to Turkey (via Blue Stream), and seems likely to attempt to retain its influence in the European market.³³ Second, the EU's relations with Turkey are a difficult issue in their own right: high-profile analysts are already asking 'who lost Turkey?' Indeed, according to one, citing the work of Olli Rehn, EU enlargement Commissioner, it is a 'slow-motion "train wreck", and the imminent crash of Ankara's EU bid is a disaster for everyone'.³⁴ Of course, it may be that strategically placed Turkey, needing the income of transit routes, might not pose a threat to the flow of energy, but how a deterioration of relations between the EU and Turkey might impact on the security of Europe's energy transit routes deserves careful consideration.

The point to be made about diversity therefore is that it poses its own problems. It

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is a means to greater security, but the end must be very carefully planned. Current calls for greater diversification represent knee-jerk reactions rather than this carefully thought through strategic means. Greater diversity in transit routes poses its own questions and difficulties, and there is a lack of better options in terms of producers – except perhaps Qatar and Saudi Arabia, diversification to which would simply represent false diversity.

EU Energy Security: Domestic Responses

In fact, Europe's energy security remains to a significant extent in its own hands – not those of Russia – and Europe's relatively favourable energy security position (in comparison to some other major consumers) is too often forgotten amidst the concerns about soaring foreign dependence. Indeed many of the problems currently faced, including the increased 'dependency' on imports, would be better addressed by domestic improvements rather than a more compliant or friendly Russia (or any other 'producing' state). First, consumption should be reduced through greater efficiency. The methods are well known: greater incentives (carrot and stick) to improve consumer efficiency. 'EU' Europe leads the way in efficiency but there is room, particularly in the new member states which depend most on Russian energy, for significant improvement. In an increasingly interconnected global energy network, reduction of consumption remains the only way to avoid being vulnerable to price fluctuations and tightness in the market, whatever the cause.

Furthermore, amidst the concerns that European domestic hydrocarbon production is falling, it is often forgotten that Europe remains a major energy producer, most particularly due to the hydrocarbon reserves – especially gas – in the North Sea. There needs to be a coordinated investment strategy to ensure that the plateau and decline is as slow as possible.

The oft-cited argument is that North Sea hydrocarbon production is in decline, with barrels of oil equivalent (boe) falling from approximately 4.5 million boe per day to below 3.5 million. This masks a more complex situation which reflects the debate between the peak and optimist camps. The major, easily accessed fields are indeed mature. But technological advances are prolonging the lives of the more mature fields and several areas remain even to be fully explored. Furthermore, the problem is not so much the growing shortage of hydrocarbon reserves – significant reserves remain, and political stability, high energy prices and demand increase the interest in continuing high-cost investment in the North Sea. Estimates vary, but one source suggests some 23 billion boe,³⁵ and a UK government source suggests 15-20boe.³⁶ So despite the plateau in oil production and waver in the increase in gas production, the region will remain an important crude oil and natural gas producer.

The problem is more one of investment in exploration and production: a significant portion of the remaining reserves are harder to access and require technical innovation. This alters the balance of companies involved in the process. Larger companies are less interested in exploiting smaller fields or the fringes of large, more mature fields, preferring to focus on larger projects. Smaller companies are better suited to extracting the sometimes substantial remains from these mature fields at profit.³⁷

Government has an important role to play in stimulating the interest of companies and enhancing this balance by adapting licensing and regulations to allow

companies to explore before finance is arranged, prevent companies from not exploiting discoveries for long periods and facilitate access to pipelines to allow smaller companies to transport their oil to the market. However, the uncertain tax climate created by the UK government has prompted some in the oil industry to suggest that this threatens the North Sea's future and damages the small companies it seeks to attract. As noted in one high-profile publication, this is an 'odd time for ministers to be mucking about with energy taxes'.³⁸

Finally, there needs to be much more political and material investment in an interconnected European approach to energy security at a European level. Indeed, it is the perceived lack of such an approach which generates the lack of confidence in the EU's ability to work together to enhance the energy security of all and which lies at the root of both the Polish use of the veto in EU-Russian negotiations and the calls for a greater NATO involvement. Warsaw is concerned that Poland will be effectively isolated by the Baltic Sea Pipeline. Calls for greater NATO involvement also emerged because of doubts that the EU can – or wants – to play a meaningful role providing political support to Eastern and Central European states in resisting Russian pressure.³⁹ A more interconnected approach would maximise the benefits of the existing diversity of energy type, source and transit route. Currently European interconnection is largely limited to bilateral links and the energy market is 'not much more than a series of national networks with limited cross-border trade', resulting in individual member states carrying a 'high burden in spare capacity', the limitation of trading and lower security of supply. Each new interconnection would add security, as would a much wider exchange of information across the region.⁴⁰

This is an enormous task however, reflected in the fact that these points have been recognised for some time but not yet realised in practice. This is in large part because Europe's energy agenda is deeply fragmented, not just in the approaches of different member states to the threat posed by Russia and the attempts to retain national control over energy security as opposed to EU or NATO control. Businesses and companies have often espoused different aims with regard to Russia, in parallel with negotiations by their national government or the EU. This is exemplified by the differences in priority – politically, the focus has been on persuading Russia to ratify the ECT, but some businesses argue that the focus should be elsewhere: Richard de Lange, Head of the Dutch energy industry lobby *Energiebond*, argued that 'a mutually satisfactory relationship between the EU as a consumer and Russia as a supplier is not furthered by a fruitless discussion on the ratification of the ECT'.⁴¹

Different members also espouse different approaches to energy, some, such as the UK, supporting a more liberal and competitive approach, others favouring a more national approach, providing support for national energy champions. Therefore the Commission's efforts to increase competition in the internal energy market are likely to be rejected by states such as France when presented at the EU summit in March. There are divergent approaches in the European Council and European Commission, some viewing the issue to be an internal market one and therefore in the remit of the Commission; there seems to be little consensus that a foreign and security policy approach is also necessary (since the EU is increasing its imports from non-members), either within the Commission or the Council. Such divergent aims undermine the ability of Europe to develop either a coherent broad strategy or even a unified approach to Russia more specifically, which allows Russia much greater freedom of movement in negotiations.

Conclusions

In conclusion, two main points stand out. First is the ongoing need for a coherent strategic plan for Europe's energy security, one to which a majority of the differing energy influences subscribe. Such a plan would link both domestic and external dimensions and concentrate predominantly on enhancing the domestic situation. Many of Europe's energy security problems would be better served by a more coherent European position and domestic improvements than by a more friendly Russia, or by attempting to oblige Russia to change – not least because there is less and less that can be done to influence Moscow to change. Such measures include greater efficiency (particularly in the new member states), coherent legislation to encourage development of domestic resources (particularly those in the North Sea) and greater interconnection within the EU. The need for such a plan is widely recognised, and the Commission is attempting to develop one. Yet it is difficult to put into practice, in large part because of the range of differing, and often mutually exclusive agendas. The domestic part of such a plan is too often overlooked as the concerns about the reliability of external suppliers dominate.

Second, despite the evolving understanding in some EU circles about the type of threats posed by Russia, suggested solutions to the security of energy supplies have been reactive and not driven by consensus. The threat posed by Russia is often taken out of strategic context and in consequence both misrepresented and misunderstood.

The most prominent suggested solution to the problems posed by Russia, which has been the thematic focus of this paper, is further diversification of energy type, source and transit route, particularly away from Russia. This reflects a lack of confidence in European strategic thinking, an over-focus on one issue (Russia), and a general lack of contextual strategic horizon – and, on a different level, the use of Russia as a political lightning rod to shift the blame and avoid having to grasp difficult domestic policies.

The key to the argument posed by the paper is that there is a difference between *complex diversity* as a positive strategic approach – reflected in long-term plans to develop the use of a variety of energy types, a range of transit routes and relationships with a variety of suppliers – and *diversification*, which is a reactive and essentially short term approach which does not see the wider strategic horizon, either 'horizontally' in terms of the current global context, or 'vertically' in terms of the consequences of such as action in the short, medium and long term.

Such reactive diversification poses a number of conceptual and practical problems. Conceptually, diversification in this sense is the essence of the 'producer vs consumer' image of energy security, whereby the interests of each party are seen largely in isolation and often in competition (or at least not mutually beneficial). But energy security is more usefully understood to be an inter-relationship between producer, consumer and transit states, not least because most states involved in the equation are all three. Thus, what is needed is greater engagement and stronger relationship building along the whole length of the energy supply chain. For all the potential complexities of a NATO involvement in energy security, this conceptual approach has already been grasped by the NATO leadership. It is important that others do so as well.

Practically, there would have to be significant investment in developing new

infrastructure (new pipelines, new LNG terminals and so on): much *more* investment, in fact than in developing either domestic resources or enhancing existing relationships, including Russia. Yet alternative suppliers such as Iran or Turkmenistan are not noticeably better options either in terms of political atmosphere or in energy reserves than Russia: the EU would still have to import large quantities of gas from states which do not espouse similar values (market or political) and indeed which may have less sustainability than Russia. Qatar and Saudi Arabia are both good options as suppliers, and relations are being developed with them, but they do not represent real diversification. Increasing gas imports from these states simply compounds EU dependence on the Middle East for gas as well as oil. Even in 2004, the IEA's Chief Economist Fatih Birol was anticipating that by 2030 35% of the growth in the EU's gas imports would be covered by the Middle East, as opposed to 31% by West and North Africa and just 18% by Russia.⁴² Given both the instability of the Middle East, such an outcome would not represent a significant improvement in the security of EU energy supplies.

In any case, for greater diversification to work effectively, there would still need to be much more coherence in agenda setting and division of responsibilities. To be effective, greater diversification of source and transit route would also require a much more engaged, forward foreign policy position in both the neighbourhood and in areas where the EU does not yet have a firm footprint, such as the Caucasus. This may prove difficult to achieve. The net effect of diversifying away from Russia might be to undermine both an important, mutually beneficial existing relationship and Russia's economic growth and stability – which would be an important political and security concern for the EU, since Russia is the EU's largest neighbour with a lengthy common border – while not noticeably improving the security of the EU's energy supply.

What is necessary, therefore, is a coordinated strategy which does not have Russia as its gravitational focus. Nonetheless, this would be a strategy that recognises the strategic importance of Russia to Europe's energy security, and one on which can be built a unified approach towards it, seeking to engage it on appropriate terms. The three-way split between companies, member states and institutions renders this difficult. Nonetheless, the grounds for engagement exist – the Energy Dialogue, for all its flaws, provides some basis for the development of a political relationship. And there are many companies already involved in Russia – a recent European Round Table of Industrialists report suggests that current investment in Russia by its member companies totals more than 32 billion Euros – and seeking to develop this further in step with diplomacy.⁴³ On this basis should be built a more solid partnership, with cooperation across a range of aspects, not just in exploration and exploitation, but also in sharing experience and developing and enhancing efficiency of consumption in Russia.

Endnotes

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Want to Know More ...?

See:

Fredholm, M. *Gazprom in Crisis*, CSRC paper 06/48, October 2006

Milov, V. *The Power of Oil and Energy Insecurity*, January 2006, www.energypolicy.ru

Monaghan, A. *Russian Oil and EU Energy Security*, CSRC Paper 06/65, November 2005

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