

By Ksenia Gorlevaya

In the aftermath of the Russian-Georgian war, amongst geopolitical, ethnical, moral and even religious questions one critical to major stakeholders is -- is there now any risk to EU-Russian energy contract obligations? The question has been directly posed to Russian Prime Minister Putin and comments made by many senior Russian officials. Mr. Putin gave a very clear answer to this. Russia has "no intention" of limiting oil and gas exports to the EU and the country "will abide strictly" by its contractual obligations he told the Interfax news agency (31 August). What he also said is that his country's energy reserves will flow to the Far East if European leaders seek to punish Moscow for invading Georgia.

The European leaders perceived this last statement as a direct threat to European energy supply security. UK Prime Minister Brown reacted immediately - no nation can be allowed to exert an energy stranglehold over Europe. However, was this reaction well founded? Is there a plausible scenario under which Russia would cut off the supply of energy to the EU in the foreseeable future? Is there a real threat or merely political sabre rattling?

It is essential to grasp the scope of mutual dependencies between the two parties. The facts of the EU-Russian energy relations are well known. As a high energy consuming economy, the EU is now faced with increasing dependency on its gas and oil suppliers. Russia is the biggest supplier of gas to EU countries. The list of the consumer countries is extensive - Austria, Armenia, Azerbaijan, Belarus', Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Germany, Greece, Hungary, Italy, Finland, France, Lithuania, Latvia, Kazakhstan, Macedonia, Moldova, Montenegro, the Netherlands, Poland, Rumania, Serbia, Slovakia, Slovenia, Switzerland, Turkey, the Ukraine and of course the UK.

The gas business has defined time frames. Both the infrastructural investments and the trade contracts are matters of 25-30 years periods. The largest current gas supplies are Russia, Qatar and Iran. While Qatar is developing liquefied natural gas (LNG) and Iran is engaged in a geostrategic struggle with the UN Security Council, Russia has always been a major gas supplier to Europe. The first supplies in Europe started in 1940s with the Soviet-Polish gas deals. Ever since, most significant deals between the EU and Russia have been about natural gas supply. The EU-27 is dependent on Russia for 25% of its gas and 25% of its oil.

However on the Russian side the interdependency is also strong. Sales of raw materials to the EU provide most of Russia's foreign currency and contribute over 40% of the Russian federal budget. It accounts for one quarter of its total GDP and just under one third of its total industrial production. Russian exporters also are oriented at developing EU as potentially ever growing market and thus invest heavily in targeting the EU as its major customer. Accessible and lucrative markets for Russian energy are therefore essential. Russia is dependent on the EU with its vast market power and potential (although some argue not as dependent as Europe is becoming on Russian supplies).

Russian suppliers are constrained by the gas pipelines infrastructure that is Europe-oriented. The ideas of redirecting the gas flows to China for example are unrealistic in short and even in medium terms as this would require building an extensive new transportation grid in the region.. These investments would have heavy if not impossible costs for the major Russian energy player OAO Gazprom, and perhaps require external expertise too. This is not to say that the investments already poured into the European infrastructure which account up to 20 billion US dollars a year, would not pay-off in such circumstances. Moreover given that the EU imports such a high percentage of the gas it needs from Russia, the Russian gas industry is effectively being maintained by revenues from its exports to Europe. And while Russia tries to diversify its gas industry profit sources by introducing market prices in the Newly Independent States, it is obvious that only if Russian earnings from European gas imports drop considerably will it be time to question whether Russia can afford to jeopardise its secure gas supplies to Europe.

Thus both sides of the EU-Russian energy dialogue are crucially interdependent. If reduced from the political discourse the current relations are to a great extent not the matter of decision of whether to cooperate or not but a pure economically rational choice of minimizing the added costs of selling and buying of one of the key generators of societal welfare.

Present concerns among officials and media about the possibility of the Russians cutting off the supplies of gas and oil to the EU as a response criticism of its actions in South Ossetia are misunderstandings and misinterpretations of messages that Russia is sending via the comments of its highest ranking officials.

As stated, deterioration of relations between the EU and Russia is not in Russian economic interests. Russians can not afford this at the moment. Dependency of the Russian economy on its exports to Europe is not what the Russians want. They will seek to diversify their export markets. The Russians take the European efforts to find alternative energy suppliers and sources seriously. Moreover Europeans and Americans have already voiced the possibility of introducing economic sanctions against Russia. It sends two message to their partners – it reassures them of their reliability on the one hand and on the other shows that they would not under any circumstances be victims of blackmail.

It is logical that to secure the source of their main income Russia looks for new deals outside of the EU. If this goes with continuing energy trade with the EU this is a bonus. If not, the alternative will provide economic stability to what is now an energy-export-dependant country. Thus the current moves by Russia should not be taken as aggressive or threatening towards Europe. They are better taken as the business expansion of a profitable company and an attempt to secure its assets and operations. The fact that these attempts happen in times of political instability between the business partners demonstrates that the Russians have accelerated the process when being threatened by partners directly.

As the Europeans protect their supply security, so does Russia protect its demand security.