

Russia-Europe Energy Relations

Implications for U.S. Policy

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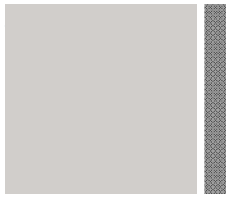
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RUSSIA-EUROPE ENERGY RELATIONS

IMPLICATIONS FOR U.S. POLICY

Keith C. Smith

Summary

It is my thesis that the national security risk posed by Russian energy policies are only tangentially related to Europe's dependency on Russian energy imports. The primary energy risk to Europe, and especially to the newer EU members, stems from the corrosive effect this dependency has on governance and on transatlantic cooperation. Moscow's divide-and-conquer tactics have successfully prevented greater inter-European cooperation on both economic and security issues. As we shall see, these factors have added to already existing strains in the U.S.-Europe relationship. Further NATO enlargement has been stopped, in part, due to Moscow's energy ties with the wealthier Western European states. It is in the U.S. interest to assist those Eastern and Central European (ECE) states that are highly dependent on Russian energy imports and are most susceptible to imported corruption. Kremlin officials, supported by 60 percent of Russian public opinion, favor reestablishing Soviet-era control or influence over ECE countries. The threat to the sovereignty of these new democracies cannot be dismissed.

Since the collapse of the Soviet Union, Russian officials have attempted to exert influence on their immediate neighbors by withholding or threatening to withhold vital oil and gas shipments. This occurred as early as 1990 and most recently took place with the well-publicized gas cutoff to Ukraine in 2009. A variety of Central European countries have been targeted as a result of Moscow's ire, including the three Baltic States, Belarus, Poland, the Czech Republic, Ukraine, and Georgia. Much of Europe, however, only saw this as a threat to its own interests when in early 2009 Western Europe and the Balkans were directly hit by the disruption in gas shipment to Ukraine. This latest energy disruption and the recent election of a new EU Commission and Parliament may bring an opportunity for more fruitful dialogue among the United States, European Union, and Russia regarding energy questions.

The U.S. government's ability to influence European energy policy has significantly diminished over time, although it was never as great as some members of Congress or the State Department officials believed it to be. The United States must be realistic about its ability to influence energy policies in Europe, Russia, and Central Asia. There is certainly no one policy that will improve the energy security situation in Eastern and Central Europe. Technological breakthroughs and incremental advances in energy efficiency may have more of an impact in the region than U.S. or

European government policies. Nevertheless, there are some steps that the United States can take that might help Eastern and Central Europe achieve greater energy efficiency and import diversification and could possibly temper Moscow's willingness to use energy exports for coercive purposes.

Recommendations

1. The United States should use the long moribund U.S.-Russia Energy Forum to push for an enforceable code of conduct for international energy firms, for greater accounting transparency and enforcement of competition laws, and for more reciprocity in foreign investment policies. The code would apply to importers outside the Organization for Economic Co-operation and Development (OECD), as well as companies from OECD member states. Any breakthrough on transparency and good governance would set an example that would be easier for others to duplicate in their own energy relations with Moscow. It would also improve Russia's ability to reach long-term contracts with ECE states.
2. The energy game changer in U.S. energy relations with Russia (and others) has been the rapid developments regarding shale and tight gas. Similar production of unconventional gas in Europe, and particularly within the ECE countries, would increase Europe's bargaining position with the monopoly exporters Transneft and Gazprom. Although several U.S. energy companies are already busy exploring possible nonconventional gas fields, particularly in Poland, the United Kingdom, and Hungary, the U.S. Geological Survey has technical expertise that could help speed the geological mapping in many of the Central European states. Many of these countries lack the technological skills that would allow them either to compete or cooperate effectively with large multinationals in utilizing the new extraction technologies.
3. Joint research and development (R&D) funding by U.S. and ECE companies in search of cleaner and more environmentally acceptable drilling techniques in the hunt for nonconventional gas might speed public acceptance in an already environmentally skeptical Europe. New "cleaner" drilling techniques of the type being developed by some U.S. oil service companies, would have to be widely used in Europe in order to gain support for field development in the more built-up areas of Eastern Europe.
4. The Energy Council could also be a forum for the United States to press for more transfer to Eastern and Central Europe of technology on carbon capture and sequestration (CCS), energy efficiency, introduction of more renewable energy, and development of "smart grids." While Europe may already be ahead of U.S. industry and Department of Energy (DOE) labs in some of these areas, the United States could offer to support "twinning programs" in ECE countries in conjunction with Western European governments. The goal would be to more rapidly transfer the latest technology to ECE countries, while at the same time securing project financing by the international financial institutions (IFIs).

5. Another subject for the U.S.-EU Energy Council discussion could be U.S. and EU reaction to political changes in Turkey and Ukraine and how to integrate the two countries into a transparent and commercially viable system of energy transit, particularly from Caspian region fields. While it is understandable that there is a high degree of “Ukraine fatigue” in Brussels, the United States should continue to provide technical expertise to Ukraine and back financing of energy infrastructure projects by the European Bank for Reconstruction and Development (EBRD) and World Bank. Ukraine is just too important to ignore.
6. At the same time, the United States should explore the idea of offering Russia technical help in developing its own nonconventional gas industry and in capping and utilizing the enormous amount of flared gas emanating from a variety of Siberian fields. This good faith offer, whether accepted or not, might act as a carrot to secure better behavior on the part of the energy czars in the Kremlin and at the same time add to Russia’s stock of gas available for both domestic use and export. Larger stocks of Russian gas would not likely undercut the market for alternative sources for Europeans. It might, however, help keep export prices from rising more steeply than they would otherwise.
7. U.S. officials can work cooperatively (and quietly) with their European counterparts to persuade major gas exporters not to turn their present informal discussion forum into a “gas OPEC.” U.S. and European leaders could also play a more active role in developing closer relationships with Central Asian leaders. Governments could encourage major Western energy companies to provide more scholarship funding for young professionals from these countries, particularly for those studying energy-related disciplines.
8. The Department of State should work more effectively to build a corps of foreign affairs energy specialists, both in Washington and in European capitals. Too often in Central Europe, the energy officers in U.S. embassies are either first or second tour Foreign Service officers, with only limited experience in energy matters. Information gathering on energy issues by embassies should be made a higher priority. In addition, many U.S. energy companies are too often reluctant to ask for support from embassies, not recognizing that the government can assist in developing local business contacts and helping surmount the bureaucratic hurdles that have to be overcome in energy ventures in ECE countries.
9. The United States should encourage the European Commission and major member states to more vigorously support the territorial integrity and sovereignty of Georgia and Ukraine—both countries being key transit routes to Europe. The present EU policy toward Tbilisi only encourages those in the Kremlin who seek to destabilize Georgia and discourages the construction of non-Russian controlled pipelines through that country.
10. The United States could encourage the European Commission to undertake a new feasibility study regarding the commercial viability of the Odessa-Brody pipeline. Russian supply disruptions in the Baltic Sea region, the opening of new refineries in Baltic countries, and decreasing crude oil supplies from the North Sea warrant a new look at the project.

11. Prime Minister Vladimir Putin recently stated that Russia would return to a policy of encouraging foreign investment in the energy sector. He added the caveat that Western firms would be required to trade ownership in their downstream facilities for the right to participate in upstream ventures in Russia. U.S. officials should hold consultations with EU officials and individual European governments regarding a possible response to Putin's demand. If the Kremlin secures control over key Western energy assets, ECE countries could become even more dependent on Russian "good will" since many Western European firms own substantial shares in ECE energy companies, including vital refineries and pipelines.

National Security Implications of Russian Energy Policies in Europe

A decade ago, U.S. power was overwhelming and any administration would have been able to persuade the large alliance members to follow Washington's lead on enlargement issues. Today, Berlin, Rome, and Paris show greater reluctance to pursue any alliance policy strongly opposed by Moscow. In addition, U.S. support for greater diversification of energy supplies for the more vulnerable countries of Eastern and Central Europe has been undercut by resistance from major Western European states. More important than European energy solidarity is their hope for a larger financial stake in energy projects promoted by Russia. These ventures may only increase Europe's vulnerabilities.

Even with Russian oil production flattening and gas exports in temporary decline, Moscow has continued to use its energy revenues to buy downstream energy facilities in Europe. At the same time, Gazprom representatives have strengthened their influence with political leaders in key transit and consuming countries. The Nord Stream and South Stream gas pipeline projects, opposed by many of the United States' closest friends in Europe, is gaining momentum, thanks in part to Moscow's ability to recruit and pay substantial salaries to at least two former European leaders. Additionally, in some European countries, officials reportedly benefit from their financial ties to Russia's Gazprom, thereby furthering European acceptance of Moscow's pipeline projects. These ventures are designed primarily to tie Europe closer to Russia politically, while decreasing the possibility that competitive non-Russian pipelines, such as Nabucco, will be constructed. Although a case has been made that Nabucco is not and will never be commercially viable, it is not less viable than the Nord Stream and South Stream projects, and it adds to, rather than decreases, Europe's dependency on Russia. The security implications of these ventures should be examined in more detail by U.S. and European policymakers.

In recent European and U.S. commentary regarding Moscow's coercive use of its energy exports, there has been a tendency to downplay the security and political impact of Russian policies on the United States' European allies. Decreased world prices for oil and gas, coupled with the increased availability of liquefied natural gas (LNG) from the Middle East and Africa, are pointed to as factors that will reduce European dependency on imports from Russia. Other factors being cited are the expected decline in Russian oil exports beginning in 2010 or 2011, a possible reduction in

European energy demand as a result of improved efficiencies, and the greater introduction of renewable energy sources. Another possible consideration mentioned is the weakening dominance by the Kremlin of Central Asian energy producers, particularly as these countries complete new gas and oil pipelines to China. It is possible that this would make Russia even more financially dependent on its energy sales to Europe, thus forcing Moscow to adopt a more constructive (i.e., less political) posture toward the energy consuming countries in Europe, including the ECE states.

All of the supply and demand factors cited above are happening, although the political impact on the energy market of these changes is not yet clear. First, while energy demand in Europe is essentially flat, some traditional sources of non-Russian energy are slowly drying up. Norway's oil production is decreasing at a rapid pace, as is output in the areas off the coasts of the United Kingdom, Holland, and Denmark. Natural gas output in the United Kingdom, Holland, and Denmark is also quickly declining, and Norway must eventually explore new fields in the difficult and expensive Arctic region in order to maintain present gas production levels. With new giant fields more difficult to find and develop off the coast of Norway, that country's Statoil Company is developing closer ties with its Russian counterparts in developing the Russian Arctic and with oil and gas fields in locations as far away as Iraq. The implications of Norway's energy ties with Russia are unclear at this point.

LNG imports into Europe from Qatar and from Africa will probably increase significantly in the next five to seven years, and this could add to Europe's energy security, although not as much in the ECE countries as in Western Europe. If Russia speeds up development of new fields, it may be in a position to undercut LNG imports through deeper price discounts and the use of cheaper pipeline systems. This could benefit Europe if it increases price competition, but it would be detrimental if it is used to squeeze out competitors, thereby adding to its present near monopoly role in several markets. It should be noted that the International Energy Agency (IEA) recently announced that "peak oil" production could occur as early as 2020, although this conclusion is disputed by several respected energy specialists. If the dire warning were to occur, it may increase pressure on Europe to shift some energy production and even transportation fuels from oil to natural gas, while at the same time being forced to move from coal to natural gas as a result of climate change agreements. All these factors may work to the advantage of Russia and other suppliers. While Russian domestic demand for energy is growing, vigorous efforts by Moscow to improve domestic energy efficiency and to utilize the large quantity of gas now being flared could significantly increase Russia's export capability and exert a downward pressure on European gas prices, by itself not a bad development.

The big "known unknown," however, is the implication that development of nonconventional natural gas (shale and tight gas) will have on Europe. This advancement has substantially changed the energy equation in the United States, virtually eliminating Moscow's hope that the United States would become a significant market for Russian LNG. It could also decrease Russian pricing power in other markets (assuming no wholesale shift from oil and coal to gas). This may result in more gas from Russia, Nigeria, and the Middle East being available for

European consumption, thereby undercutting Moscow's political leverage and price advantage. At this point no one has come forth with a good estimate as to what impact nonconventional gas production will have on Europe. Although exploration is being ramped up in several European countries, early indicators are that this will not have as large an effect on Europe's energy supplies as it will in the United States. A recent joint exploration project by ExxonMobil and MOL in southern Hungary failed to recover any gas at all (although there may be gas at deeper depths). Environmental resistance to production from Europeans will be stronger than in the United States. The exploration for unconventional gas in Europe is, however, a promising development.

Therefore, it is difficult to estimate whether Europe's dependency on Russian energy resources will increase or decrease over the next 10 to 20 years. Most projections show an increasing dependency on Russia between now and 2030, but supply dependency is only one of the issues. Also important to consider, in addition to demand levels, are Gazprom's monopoly and pricing policies, the degree to which Russian economic transfers remain highly nontransparent, and even Russian commercial and security policies. The projected completion of the Nord Stream pipeline by 2015 will increase German dependency on Russia. This might not occur, however, if an oversupply of LNG on the world market results in gas landed in the United Kingdom that can compete price-wise with more expensive gas expected in the next 5 to 10 years from Russia's Yamal and Shtokman fields.

What we do know is that many Western European investors and their governments are anxious to profit from Russia's energy resource base. The governments, however, should consider whether specific investment decisions by their companies might, in the long run, increase their national political dependency on Moscow, thereby undermining European and transatlantic security interests.

The Challenge to Eastern and Western Europe Differs—A Factor in U.S.-Europe Relations

The large EU members of Western Europe, those who are the most resistant to a binding energy policy for all member states, are less dependent on Russian imports, have access to pipelines and LNG terminals connected to non-Russian suppliers, and have strong energy companies that can offer Moscow access to financing, technology, and large markets. The countries of Eastern and Central Europe have fewer alternatives and are from 70 to 99 percent dependent on gas and oil imports from a single market. Not surprisingly, they tend to favor a common EU energy market. In spite of their greater dependency on and vulnerability to Russian supplies, the ECE governments receive less EU funding for energy projects such as interconnectors than do the wealthier member states to their west. EU energy solidarity remains surprisingly weak in spite of two natural gas cutoffs by Russia in the past four years.

Although one would expect the Eastern and Central Europeans to be more concerned than others about the imperial tendencies of their large eastern neighbor, their worry is compounded by their

high degree of energy reliance on Russia. It is well documented that the ECE states' greater dependency has been used repeatedly by Moscow over the past 19 years in attempts to intimidate, punish, or blackmail governments over a variety of political and commercial disputes. Until the Western Europeans were directly affected by the Russia-Ukraine gas dispute of January 2009, the mantra they repeated constantly was that Russia was "always a reliable source of energy." One hears this less often than in the past, but there is still a greater faith in Russian "good sense" and its willingness to abide by commercial agreements with the "old" European Union than with the "new" ECE member states.

Western Europe's greater wealth, military strength, and physical distance from Russia only adds to its confidence in dealing with Kremlin leaders—and to a feeling that the protection the United States once supplied, including the "nuclear umbrella," is of little importance in this day and age. However, the ECE countries continue to feel the need to have a strong U.S. presence, including permanent military forces, in Europe. At the risk of angering Moscow, the Baltic States, Poland, Hungary, and the Czech Republic have at various times expressed a desire to have U.S. and/or NATO forces on their territory for long periods of time. They are also the NATO member states most supportive of further NATO enlargement. Five years of EU membership has amply demonstrated the failure of the larger member states to provide the ECE countries with the "soft security" that they had hoped to receive when they joined in 2004.

Some have been disappointed that the European Union's loudly promised military force has failed to materialize. The more anxious of the ECE countries, however, are relieved that an EU force has not come into being, believing that it would only have reduced NATO protection against a resurgent Russia. Worth noting is the fact that if one takes into account the per capita military contributions of individual EU member states to the wars in Iraq and Afghanistan, it is obvious that the ECE countries are "punching above their weight" in supporting U.S. military policy. ECE leaders readily acknowledge that their greater military contribution to U.S.-led efforts is a trade-off for U.S. protection in the event of a serious threat from Russia.

The ECE countries are well aware of who would and would not provide strong military and other support in the event of a conflict of any kind with Russia. No group of EU countries is more conscious of the failure of the Europeans to enforce the military disengagement agreement regarding Georgia signed in August 2008 by Russian president Dmitry Medvedev and French president Nicolas Sarkozy than the ECE states. They have also noticed Western Europe's refusal to help rebuild Georgia's military forces. ECE countries hoped that the European Union and the OSCE would have pressed harder, after the Sarkozy-Medvedev agreement, for neutral peacekeepers to be allowed into Abkhazia and South Ossetia. The ECE states have noticed that Western Europeans have also reacted passively to the Duma legislation of October 2009 that allows force to be used outside its territory to "protect Russian citizens" who are allegedly endangered. While the EU presidency has dismissed Russia's claim to a special zone of influence in Eastern and Central Europe, the Caucasus, and Central Asia, the negative reaction in Washington was noticeably sharper than that coming out of Brussels. The failure of the European Commission to politically defend Latvia and Lithuania in the face of Russia's arbitrary cutoff of

oil imports was also a clear sign to the ECE states that they cannot count on EU support when Russia uses economic coercion against them.

U.S. Policy on European Energy Diversification

The United States has long had a strong interest in the source of energy supplies directed to its European allies. However, with the end of the Cold War, U.S. leverage over European policy has increasingly diminished. The strengthening of the European Union has, not surprisingly, also reduced political cooperation between the United States and much of Western Europe, including a greater reluctance to take U.S. advice regarding Russia-Europe relations. Accordingly, U.S. attempts to reduce Moscow's ability to use energy exports as coercive tools have had only mixed success.

Most of the ECE countries, however, are supportive of U.S. efforts to open direct energy routes to Europe from Central Asia, particularly since these nations are the most highly dependent on the Russian monopoly suppliers Transneft for oil and Gazprom for natural gas. U.S. policymakers have been more attuned to Russian energy pressure on Eastern Europe than the major countries in Western Europe, with the exception of Sweden and the United Kingdom. Within NATO, a block of countries led by Germany has resisted U.S. and Polish efforts even to put the issue of energy security up for debate. The same group has also prevented an agreement on a common EU security strategy and a unified energy market. There is no strong evidence so far of a Western European backlash against U.S. support for energy diversification. Russia's press, however, have labeled U.S. pipeline policies as interference in European internal affairs.

U.S. attempts to influence Europe-Russia energy relations go back some time. In 1984–1985, Washington pressured the Europeans, including Margaret Thatcher's United Kingdom, not to supply steel pipe for Russian oil and gas shipments to Europe. General Electric was barred by the Reagan administration from selling compressors and pumps for a gas pipeline to the Soviet Union or Germany. The U.S. effort was not particularly successful, however; it only delayed somewhat the sale of German pipe and other equipment to Moscow for the construction of a gas line to Europe. The major factor influencing Soviet energy revenues, however, was a direct result of the sharp decline in production between 1988 and 1992. This had little to do with U.S. policies and was, in part, due to deepening inefficiencies in Soviet energy production and a quick drop in world oil prices. Soviet government income decreased considerably as a result of these factors, undermining support throughout the Soviet Union for the tottering Communist leadership in the Kremlin. Decades of selling oil at giveaway prices to its Warsaw Pact allies added to the drop in Soviet revenue and only aggravated the existing inefficiencies in production.

The world oil crisis that stemmed from Middle East shutoffs in the 1970s, plus the new power of the Organization of the Petroleum Exporting Countries (OPEC), added to the determination of Europeans to diversify their supplies of energy to new areas, and none was more apparent as a ready alternative than the huge energy base in the neighboring Soviet Union. Pipelines from nearby non-OPEC member, the Soviet Union, were viewed as more reliable than shipments

through the Suez Canal, which were reliant on politically unstable Middle Eastern governments. From a European vantage point, increasing diversification of oil and gas imports from Soviet production fields made economic and political sense in the 1980s. For the United States, the Arab-Israeli conflict reduced Washington's ability to influence oil production in the Middle East and diminished its already declining influence over energy issues in the capitals of our closest European allies. At one point, the Washington turned to NATO in an attempt to influence European energy policy. Even there, however, the United States' sway over strategic economic issues had declined since the early 1980s. Once Soviet president Mikhail Gorbachev came to power, major European leaders rushed to provide bank loans and other financial incentives to the new Soviet leadership.

Beginning in 1990, the U.S. government had an active program to assist the new ECE democracies in developing self-sustaining energy efficiency projects. This was initiated long before a comparable effort was begun by European donors. This program was one of the most successful U.S. assistance efforts directed toward the region. It contributed to a measurable reduction in the growth of energy intensity as these countries developed an industrial base that would allow their standards of living to approach Western European levels. For example, Poland, where a significant push was made by the United States, today has a per capita energy intensity level half that of neighboring Ukraine, where energy efficiency has been adopted at a slower pace. Although U.S. assistance cannot be credited for all of Poland's energy progress, the demonstrated effect of these U.S. projects played a significant role. Unfortunately, one can see from the EU assistance budget that energy diversification for the most vulnerable of member states is a relatively low priority item. The recent 3.8 billion earmarked in 2009 for energy infrastructure projects went largely to the less vulnerable Western Europeans.

The likelihood is that Europe and the rest of the world will have a surplus of LNG for several years because of new production in the Persian Gulf and Africa and as a result of new re-gasification terminals coming on stream in the United Kingdom, Germany, Greece, Bulgaria, and Poland. This should, at a minimum, provide some price competition to Gazprom's monopolistic export role. It might also encourage resistance to take-or-pay energy contracts and provide time for the most vulnerable countries to find non-Russian energy supplies. It is conceivable that this could convince Russians that it is in their country's interest to conduct more transparent and strictly commercial energy policies with their European neighbors. If Vladimir Putin returns to the presidency in 2012, however, the chances are more likely that Russian energy policies will retain their lack of transparency.

Russia's prime minister appears to be the most aggressive advocate of using energy to coerce the consuming countries. Russia, led by Putin, is presently attempting to make the Gas Exporting Countries Forum (GECF) a more aggressive body that would operate similarly to the OPEC cartel in setting natural gas export volumes and prices. With the emergence of unconventional gas technology and a larger LNG spot market, this could now be more difficult for the Kremlin than it would have been two years ago.

U.S. Role in Pipeline Politics

The Baku-Tblisi-Ceyhan (BTC) oil pipeline was first proposed by Turkey in 1992 and garnered the strong support of the United States in the late 1990s. Completed in 2005, the pipeline was designed to bypass Russia and the Bosphorus strait in delivering crude oil from the Caspian region to Europe. Washington strongly backed the project even though it was initially met with a high degree of skepticism in Europe regarding its economic and commercial viability. Washington recognized early on that European and U.S. security interests would be better protected by having at least one oil route out of Central Asia that would not be dependent on the political whim of the Kremlin. The United States also appears to have recognized earlier than many Europeans the need to court the growing energy producers of Central Asia.

Although U.S. relations with Russia were relatively good in the late 1990s, there was early recognition in Washington, and later in some European capitals, that our long-term interests would be better served if the Central Asian states achieved a greater degree of economic and political independence even from a non-Communist Russia. Eventually, a consortium of major European and American companies developed enough support in order to make the venture economically viable. Today, the BTC is the only pipeline delivering crude oil from the Caspian region's fields to European consumers, although the oil has to be transshipped by tankers from the Turkish port of Ceyhan to Europe. Nevertheless, Moscow is continuing to devise new pipeline routes in the Caspian region that might eventually undercut the profitability of the BTC pipeline and Western-supported gas pipeline schemes.

Another major project supported by the United States is the long-discussed Nabucco gas pipeline, designed to transport Caspian gas to European markets via Turkey and the Balkans. It was promoted as early as 2002 by Turkey and later supported by a large consortium then led by Austrian oil and gas company OMV. The terminal for the Caspian gas is in Austria. Although the project was designated as a priority by the European Union, it has received little support from the European Commission. Part of the hesitation in Brussels has been the lack of a fully identified source for the gas, but pressure from Russia has been a significant factor in the lack of backing by the Commission, Germany, Italy, and even Austria.

There is even less identification of the source for gas, or even a realistic price tag, for the Russian-proposed South Stream project, in which pipe would be laid on the bottom of the Black Sea before entering any European country. This has not, however, prevented Italy, Austria, Serbia, Bulgaria, Hungary, and the last EU energy commissioner from announcing their backing for the South Stream project. Proposals by Turkey and some Europeans that Russia join the Nabucco project will not likely change Moscow's strategy of controlling all of the gas export routes from Central Asia. Nevertheless, if the Nabucco project goes ahead, it is highly likely that Russia will want to participate, although in a way that would give it a high degree of control. Moscow is reluctant to participate in projects in which it is a junior partner.

South Stream was clearly designed with the intention of killing the Nabucco project, thus leaving Europe with no access to Caspian or Central Asian gas except via Russia. U.S. officials have made numerous trips to the region attempting to drum up support for Nabucco. Unfortunately, there has been less activity on the part of the Europeans, and particularly lacking has been significant involvement by the European Commission president and the former energy commissioner. Their failure to back this “priority” EU project is difficult to explain. The Azeris have reportedly questioned visitors as to why the United States has appeared to be more supportive of diversifying Europe’s gas supplies than have the Europeans. They also complained to U.S. officials that the European Commission seemed to dismiss Nabucco as a hopeless effort, while providing support for the more ill-defined South Stream. At the “Nabucco Summit” in Budapest in January 2009, the Commission and the German delegation conspicuously failed to offer their backing for this alleged major priority project. At the conference, the Azeris and the Kazakhs appeared to be disappointed with the lack of European support for a project that they were prepared to support, even at the risk of annoying Moscow.

The August 2008 war in Georgia also was a signal directed from Moscow to Washington and Brussels that any new or existing pipeline running through Georgia will be highly vulnerable to Russian military action or to sabotage. At this point, it is difficult to say whether European reluctance to support either Georgian sovereignty or the Nabucco project is related in any way to fear of angering Moscow or of renewed Russian military action. However, the European Union’s passive approach to the project and the lack of interest by major EU member states preceded the August war. There was a tendency in Western Europe to overlook Moscow’s campaign to destabilize Georgia and to goad Tbilisi into taking reckless military action against the two enclaves. Therefore, the U.S. effort to build support for Nabucco and other non-Russian pipelines has been hampered, and to some degree undermined from the beginning, by a lack of allies within the European Commission and major Western European governments.

A similar reaction occurred within the European Commission and in Berlin when Washington raised questions about the potential damage to collective European security by the construction of the Nord Stream gas pipeline. Concerns expressed by U.S. government and nongovernment officials were brushed aside by key officials in the Commission and the German government. The commercial interests of Germany’s industrial and energy companies were strong enough to override the economic and security apprehensions of the ECE countries and those of the United States. Worry in Washington that the United States is seen as more supportive of European energy security concerns than the Europeans themselves, however, has not prevented U.S. efforts to build a coalition for more gas supply diversity.

Over the entire Cold War period, the United States was a more vigorous advocate of European security than were many of our allies. No continental European NATO country ever matched the defense spending of the United States, even as they were on the front line facing a well-armed Soviet military. Today, America’s traditional allies see little or no threat from an authoritarian Russia. In the wake of the Iraq invasion, the United States has occasionally been viewed by some of our oldest allies as a greater threat to world peace than Putin’s Russia. On the other side of the

ledger, however, the membership of former Soviet Republics and Warsaw Pact states in NATO and the European Union has changed the dynamics somewhat within both organizations. The opportunity for U.S. policymakers to build a more supportive coalition of countries within NATO, however, has often been distracted by crises outside of Europe.

Due to the non-responsiveness of our major NATO allies on the issue of energy security and the need for pipelines that bypass Russia, much of the U.S. discussion in Europe in support of Nabucco and energy diversification has been with the newer members in Eastern and Central Europe, particularly the Poles, Hungarians, and Czechs. It is a case of “preaching to the choir.” At the same time, State Department officials have been traveling extensively to Ankara and Baku to consult with the Azeris in order to ensure that there will be sufficient natural gas available for Europe from Caspian fields. The United States has also been more active than the Europeans in promoting the project with the Kazakhs, Turkmen, and Iraqis.

It appears, however, that the new U.S. administration is making a greater effort to enlist the support of Western Europeans, although it will be tough going with Germany, France, and Italy. A consistent U.S. push has been directed over the past several years to convince the Turks to allow Nabucco to pass through their country without it being hindered by commercial roadblocks, nor by Turkey’s tense relationship with Azerbaijan—in spite of the fact that the project was first floated by Ankara. A successful agreement on Nagorno-Karabach, perhaps brokered by the United States, would help the project’s prospects. As of early 2010, however, there is still no Western commercial company willing to take a strong lead in putting the project together in a way that demonstrates its financial viability. It would help if Western companies were allowed to operate in Turkmenistan, a possible source of considerable natural gas.

Although some ECE countries would like the United States to put assistance money into alternative pipelines and/or to pressure U.S. energy companies to commit funds to various projects, this option is not likely to succeed. Energy projects have to be commercially viable in order to interest the private sector or even to garner parallel funding from the World Bank or the EBRD—and this is assuming a reliable and sufficient source of oil or gas has been secured. Of course, a project can receive national funding if seen as sufficiently necessary for national security purposes.

Although the United States has lent its backing to the long-discussed Odessa-Brody oil pipeline, bypassing Russia from the Black Sea to European consumers, Russian opposition alone has not been responsible for its incomplete state. A stable supply of Caspian oil has never been firmed up. Russian and Iranian opposition to sea boundary delimitation of the Caspian has prevented progress in building trans-Caspian oil and gas pipelines to Georgia. There is very little that the United States can do to change this until its commercial viability can be demonstrated.

A ramping up of Iraqi oil exports over the next few years might revive the dream of Ukrainians and Poles to complete the Odessa-Brody pipeline and make it a reliable source of oil for new and existing Polish and Lithuanian refineries along the Baltic Sea. Some ECE officials argue that it could possibly replace some of the expected decline in Russian oil production, but the project still

appears to be a long shot. The Odessa-Brody project may, however, now be worth reevaluating. Iraqi gas exports could also make the Nabucco gas pipeline plan more commercially viable.

China's rapid economic growth and its increasing need for energy imports have reduced U.S. and European ability to influence the Central Asian suppliers. At the same time these countries are slowly moving out from under Moscow's control over the region's energy supplies. China has enormous financial resources to dangle in front of the Turkmen, Kazakhs, and Uzbeks, and the recent opening of a 40 billion-cubic-meter gas pipeline from Turkmenistan to China is a stark indication of the changing power relationships in Central Asia. While the three suppliers want to diversify their gas and oil shipments away from Moscow's monopoly hold, they also see much greater new energy demand, financial resources, and political decisiveness from Beijing than from Europe or the United States. The Central Asians may still, however, want to supply some oil and gas to Europe in order to improve their political standing in European capitals and to diversify their own export markets.

The likelihood is slim that the European Commission or any major Western allies, such as Germany, Italy, or France will take over the present U.S. role of advocate for ECE energy security. Berlin, Paris, and Rome are more interested in short-term commercial opportunities for their "national champions." There is even less interest in Western Europe than in the United States of demanding that Russian companies adhere to transparent accounting and disclosure rules, or that the export monopolies of Transneft and Gazprom be required to heed EU competition and antitrust laws and regulations.

There is, however, the recent case of a Dutch court having declared that Russia was bound by its signature on the Energy Charter Treaty, at least for agreements reached before Moscow formally renounced its commitment in 2009. The European Commission has up to now accepted Moscow's claim that it is not bound by the treaty because it was never ratified by the Duma. The United States should not, however, expect any significant change in EU policy on Russian energy imports, except in the unlikely event of another shutoff of Russian gas to Europe. The Kremlin, however, apparently learned a good lesson from the January 2009 gas cutoff. Their tough approach to Ukraine only drew attention to the issue of energy security on the part of Western Europe and increased interest in greater supply diversity.

Can the United States Help Eastern and Central Europe Ward off the Kremlin's Divide-and-Conquer Tactics?

Any effort by the United States to check Russian side deals with individual countries is bound to be next to impossible without the support of the European Commission. German chancellor Angela Merkel, French president Nicolas Sarkozy, and Italian prime minister Silvio Berlusconi are not likely to react positively to U.S. entreaties to be more supportive of the energy concerns of the ECE countries. The economic stakes for the three countries, particularly for German industry,

and the lure of campaign financing from these same companies, outweigh any effort by Washington to either stop the construction of the Nord Stream or to build support for more EU funding for alternative energy projects for the newer member states. As a matter of fact, Germany was one of the strongest proponents of the shutdown of nuclear plants in Eastern Europe, whether or not there was any convincing evidence of a health risk in allowing them to keep operating.

The *aquis communautaire* agreements signed by all of the aspiring new EU members in Eastern and Central Europe obligate them to take steps to close existing energy facilities, thus making them even more dependent on Russian imports. An attempt by Lithuania, quietly supported by the United States, to allow for a few more years of operation of the Ignalina II reactor, was swiftly rebuffed by the European Commission. Most European and U.S. reactor specialists believe that Ignalina II's continued operation for at least five more years poses no greater hazard than do those operating in Western Europe. This argument got nowhere with the EU "anti-nuke" club of countries.

Italy's rush to sign on to South Stream was reportedly driven mostly by the prospect of profits by politically connected business interests. Otherwise, why sign up for a project with no identified gas source and with open-ended cost estimates? France's Total is closely linked to Russian companies in a variety of ventures. Even smaller states, such as Austria, appear to be more than willing to agree to Gazprom deals that will only make Central Europe more rather than less dependent on Russian natural gas. It is alleged by some Hungarians that Austria's OMV energy company is quietly supporting Gazprom's effort to take control of Croatia's pipelines, a step that would block non-Russian shipments of oil and gas from the Adriatic into Central Europe. The Kremlin's goal is to stop non-Russian exports from competing for Central European markets, in this way eliminating the only real source of competition. This would also effectively block the growing influence of Hungary's MOL, the most successful energy company in Central Europe and checkmate MOL's attempt to stitch together an energy coalition of ECE energy companies.

Conclusions

Moscow's ability to move fast and effectively in reaching bilateral energy deals in countries like Croatia, Serbia, and even Bulgaria is impressive. The speed and agility on the part of Russia's planners make it difficult or even impossible for the United States to mobilize sufficient European opposition to Moscow's maneuvers, particularly when faced with EU lethargy. The inability of transparent and democratic governments and of the European Commission to compete with the experienced former intelligence officers in the Kremlin, who are trained in the art of *kompromat* and bribery, is increasingly evident. It may be that the United States and its supporters in Europe will always lack the nimbleness of Moscow in creating European energy alliances. It is also likely that the Kremlin will always view U.S. efforts to promote EU import diversity as a major threat to their economic interests and a challenge to their influence in Europe, the Caucasus, and Central Asia. Even protestations by U.S. officials to the effect that their energy policies are not "anti-

Russian,” will have little effect on Russian perceptions of U.S. policies in the areas of “special interest” to Moscow.

A key problem for U.S. policymakers is the lack of energy reform in the major transit country of Ukraine. Political turmoil, corruption, and the strong position of a small group of economic oligarchs prevent the implementation of reforms that would benefit all of Europe. As long as Ukraine’s finances are in shambles, there will be continuing doubt in Europe as to Kyiv’s ability to pay for gas imports from Russia, thereby keeping alive the fear of another gas pipeline shutoff to Europe. Moscow’s argument to the Europeans that Ukraine is an unreliable transit state is widely accepted in Europe, even though Russia itself is equally if not more responsible for the gas crisis with Ukraine. The U.S. government has for the past 10 years expended funding on several energy policy assistance projects in Ukraine. Although the policy recommendations of U.S. consultants have been excellent and well grounded economically, they have, unfortunately, had little impact on Ukrainian government reform.

U.S. energy companies operating in Ukraine have either been squeezed out by pro-Russian oligarchs, or the companies themselves have been corrupted by domestic business interests. Transparent European companies have not fared any better. Since 70 percent of Europe’s gas imports come via Ukraine, the European Union has offered to help finance the renovation and expansion of Ukraine’s gas pipeline system, but to date, the lack of political and economic reform in Kyiv and Russian opposition have stopped progress on this crucial artery. Until there is greater political will in Ukraine for energy reform, there is little that the United States can do on the macro level. Europeans appear equally frustrated by the situation in Kyiv, and their proposal to assist in modernizing the major gas artery to Europe has made little progress.

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