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The interdependence of European–Russian energy relations

Øistein Harsem*, Dag Harald Claes

[a] BFE-fak, University of Tromsø, NO-9037 Tromsø, Norway
[b] Department of political science, University of Oslo, PB 1097, NO-0317 Oslo, Norway

HIGHLIGHTS

- We examine Russian–European gas (inter)dependence.
- East-European countries are most dependent on Russian gas in Europe.
- EU countries, on average, are not better off with a common foreign energy policy.

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ABSTRACT

The aim of this article is to explore this dynamic interdependent relationship between Russia and Europe in the field of energy. Based on the concept of interdependence and perspectives on the political aspects of trade relations we discuss how Russia can exercise power based on its energy resources and how the EU can compensate for its lack of power in the energy game with other trade related capabilities. In particular we explore the implications of the lack of a full-fledged EU foreign energy policy towards Russia, with the somewhat counter-intuitive conclusion that the EU countries, on average, not necessarily are better off with a common foreign energy policy.

1. Introduction

After the price fall in 1986 energy supplies were abundant and oil trade was increasingly handled at, or connected to, market-based stock exchanges. Oil had become just another commodity. When Chinese oil demand increased beyond expectation in 2003, the observed oversupply was replaced by a fear of imminent or near-future lack of supplies. Investments in new resources were lagging the increase in demand, and the oil price reached $147 in the summer of 2008. Some oil analysts claimed that it was not only a matter of supply constraints, but also a matter of resource constraints (Aleklett et al., 2010). In a situation with increased attention to resource constraints, the search for new additional resources increases and becomes more politically contentious. Geological studies suggest that most new energy resources in Europe will be found in Russian territories, primarily in the Russian Arctic offshore areas (U.S. Geological Survey, 2008). Russia is likely to increase the development of Arctic energy resources in the future, although the time table seems to be extended as both the technological breakthrough in extraction of shale gas reserves in the US and the financial and economic crisis in Europe indicates lower European energy demand than predicted only a few years back.

From an economic resource perspective, energy consumers would welcome any additional resources adding to the total reserve base. More reserves leads to more production which leads to abundant supply and falling prices. On the other hand, given their geographical concentration new energy resources could also become a source for political coercion. Thus at same time as new Russian resources adds to the global reserve base—to the benefit of consumers, the same resources can be a tool for Russian influence in, or even *over*, European politics. From a geopolitical perspective, energy resources can be a valuable asset in order to gain influence in international politics in general, but also towards ones energy customers. Mueller-Kraenner (2007) claims that "Russian leadership uses the country's key role in supplying energy to Europe and East Asia to gain back the influence in global politics that it lost when the Soviet Union Collapsed," while US Vice President Cheney concluded in a speech in April 2006 referring to the Russian–Ukrainian gas dispute, that "No legitimate interest is served when oil and gas become tools of intimidation or blackmail, either by supply manipulation or attempts to monopolize transportation." (Stern, 2006:420).

The economic and political aspects are indeed intertwined illustrating the demand for perspectives combining economics

* Corresponding author. Tel.: +47 9055 3294.
E-mail addresses: oistein.b.harsem@uit.no (Ø. Harsem), d.h.claes@stv.uio.no (D. Harald Claes).

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and political science made by Susan Strange more than twenty years ago: "What is needed is some analytical framework for relating the impact of states' actions on the markets for various sources of energy, with the impact of these markets on the policies and actions, and indeed the economic development and national security of states." (Strange, 1988:53). The Russian–European energy relation is a prominent illustration of the interaction between market forces and political interests. Contrary to conventional public opinion we will claim that the relationship between Russia and EU member states is not one of dependency, but rather a matter of interdependence. The asymmetry of the interdependence varies over time and can be influenced by the actors, creating political and economic dynamics. The aim of this article is to explore this dynamic interdependent relationship between Russia and Europe in the field of energy.

2. Russian–European energy relation

Since the dawn of international relations, natural resources have been regarded vital to the power structure of the international system of states. Although every state would prefer to have easy access to natural resources, states have sometimes had to compensate lack of natural resources with the use of other capabilities, like human capital and technological skills. In the modern world, energy resources have a prominent role as they form the basis for almost all aspects of human activity, and thus for the potential wealth and power of any state.

In public debates in energy consuming countries energy imports is usually presented as an unwelcomed dependent situation. The political goal set out is often to abolish the need for imports and achieve energy independence. Trade relations among developed countries, also energy trade, are a matter of various degrees of symmetric or asymmetric interdependence. Energy importers are dependent on the constant supply of energy, but energy exporting countries are in most cases highly dependent on the income from their energy exports. Thus, the importance of the energy for the importing country has to be weighted against the importance of the payment for the exporting country. Furthermore, dependency is a matter of alternative options (Fisher and Ury, 1981). Thus, also the availability of other supply options for the importing country has to be weighed against the availability of other customers for the exporting country.

In the international oil market the alternatives are rather extensive, as most oil is traded in a global commercial market, with common price setting and exchanges in various regions. Thus the number of potential customers and suppliers includes almost all market actors. In addition, the international oil market today contains a number of instruments for hedging against price movements both for producers and consumers. In the international gas market, this is more complicated as the countries involved are tied together by pipelines or LNG terminals and facilities, prohibiting an easy switch to other suppliers or customers.

We will proceed by describing the motives and incentives that drive Russian and European decision makers in the energy game. Then we discuss their relative bargaining power and their ability to manage the relationship. But first we need to relate the concept of dynamic asymmetric interdependence to the politics of energy and trade dependency.

3. Understanding asymmetric interdependence

Contrary to the perspectives prominent in the public debate we need more nuanced approaches to the European energy dependence on Russia. One example can be found in the following a CERA study which concludes: "that the sustainability, efficiency, and security of European energy supply will best be achieved not by hastily deciding to reduce dependence on Russian gas, but through the creation of a carefully and cooperatively managed 'interdependence' between Europe and Russia Bochkarev (2009) (Cambridge Energy Research, 2007:406)." It follows that observing an asymmetric structural relationship is only half the story, equally important is how the relationship is politically managed. We thus need to go beyond structural perspectives and look at the dynamic aspects of the Russian–European energy relationship. Two dynamic aspects will be discussed: How can Russia utilize its upper-hand in the gas relations to gain concessions or influence in other areas and how can the EU develop its resistance or compensate for its weaker hand in the gas relation with Russia?

First we will explore the actors' motives and incentives in the Russian–European energy game, in order to: "assess claims linking variation in the particular means available to states on interstates conflict or cooperation (Moravcsik, 1997): 542". Understanding motives and incentives to decision makers becomes pivotal, if one wants to predict what leaders can and will do with the tools that are available to them.

The second step in our analysis is the strategic bargaining between the parties. Here we seek to unveil the relative strength of the bargaining positions of Russia and the European consumers. The importance of the relative bargaining strength relates to the term asymmetric interdependence (Keohane and Nye, 1977). Asymmetry simply means that one party is more dependent on another than vice versa. Nye uses the term 'mutual dependency' in the same manner (Nye, 2009: 208). The fundamental observation these authors make is that pure dependence and interdependence between states rarely exists. Consequently, we are unlikely to find two countries that are either identically dependent on each other, or one of them being totally dependent on the other.

The next step is the consequences that follow from asymmetric interdependence. Hirschman claimed there is a natural connection between unbalanced trade relations and political coercion, i.e. larger states (Russia) can exploit their favourable trade relations with smaller countries in order to increase their influence and consequently their power (Hirschman, 1945). This argument has been refined and expanded by scholars pointing to two primary links between dependence and power either as: absence of autonomy or as highly asymmetric interdependence (Caporaso, 1978; Duvall, 1978; Abdelal and Kirshner, 1999). A government's trade dependence may lead the dependent state to shift or change its national interests in favour of the state that it relies upon. For instance Russia has several times exploited its trade advantages over Ukraine in an effort to alter the country's perception of Russia. "Ukraine's energy dependence on Russia has some straightforward political consequences, since Russia can in theory use this asymmetric interdependence to coerce Ukraine (Abdelal and Kirshner, 1999): 146."

Armstrong and Wagner have warned against overstating the political effects of trade dependence. This scepticism against drawing inferences about the general effects of economic statecraft is also shared by Baldwin (Armstrong, 1981; Wagner, 1988). By taking more of a conditional approach these authors have shown that only under very specific circumstances can trade dependence yield political influence. In order for economic asymmetric interdependence to become a political instrument, the cost of the punishment has to exceed the cost of compliance. According to Armstrong, three conditions need to be met: First, a large part of a state's investment should be controlled by another state. Gazprom investments in the European gas market serve as a good example (Aalto, 2008; Light, 2008). Gazprom has been able to purchase EU based companies, while Russian law prohibits European companies in doing the same in Russia. Second, the resource dependent state should be unable to