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“Strategic asymmetry in Europe-Russia gas relations: a conceptual note”  
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\*) Correction concerns only cover page, text of document remains unchanged

## **Strategic asymmetry in Europe-Russia gas relations: a conceptual note**

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### **Summary**

Europe-Russia gas relations are fundamentally asymmetric. The asymmetry reveals itself in structural economic, political and legal terms. As a result, a proper analysis of the interdependence between Europe and Russia must break free from unhelpful political rhetoric that suggests false symmetries such as 'security of demand' as a putative reply to security of supply, or 'diversification of routes' as a putative reply to diversification of suppliers. In this note we show that the aforementioned slogans are misleading and unhelpful from an EU perspective, drawing on insights from economic analysis, international relations theory, and reliability theory. We conclude with concrete policy recommendations for EU member state governments. In particular, EU member states should reject transit avoidance projects and pursue supplier diversification and strengthening of the Ukraine Corridor instead. As for security of demand arguments, they constitute standard commercial bargaining stances rather than serious security arguments and should be treated accordingly.

### ***Introduction: interdependence and the nature of asymmetry***

Interdependence means the mutual reliance of actors on one another. It is in evidence when a severance or alteration of a relationship results in undesirable transformations of a given situation for both actors. To measure the level of dependence of an actor, which is contingent on its capacity to react to changes, (Keohane and Nye 1977: 7ff) distinguish between sensitivity and vulnerability. Sensitivity denotes the costs that are inflicted on an actor by the action of another actor without policy changes, whereas vulnerability is defined as the costs that have to be borne by an actor even if he took policy measures to react. Therefore, vulnerability is the crucial concept one should use to evaluate the power asymmetries within interdependence relationships.<sup>2</sup> If an actor in an interdependence relationship is less vulnerable, either because of his capability to react or because of the lower overall significance of the relationship, he has "*a significant political resource, because changes in a relationship [...] will be less costly to that actor than to its partners*" (Keohane/Nye 1977: 11).

Two additional questions have to be answered: How does interdependence at the societal level translate into political bargaining power within different political systems? And how can interdependencies be managed by state actors in different political systems? To answer the first question it is useful to draw on Moravcsik's liberal theory of international relations and his notion that state preferences are

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<sup>2</sup> In developing their concept of power asymmetries, arising from the dependence on economic relationships, Keohane and Nye drew on (Hirschman 1945), who analysed strategies of Germany to deepen economic dependency.

defined by societal groups. The state is then merely a “transmission belt” of powerful groups in society (Moravcsik 1997: 518ff). This allows us to distinguish between “soft” and “hard” interdependence, where the first denotes the subjective interdependence that is represented in state institutions and the latter the “objective” interdependence of society (Sander 2006: 230). It follows that democratic political systems, being more inclusive by definition, have to take into account a broader spectrum of societal interdependencies than authoritarian systems, as the latter are able to severely limit access to state institutions. Furthermore, authoritarian regimes without an independent judiciary find it easier to infringe on the population’s rights. Less powerful groups then find it more difficult to communicate their interests and influence decision-making processes. Media control is used to limit access to those opportunities as well. As a result, these same groups can only consider exiting the system (Moravcsik 1997: 518).<sup>3</sup>

Political regime variables crucially impact the management of relations of interdependence as well. In liberal democracies social systems are differentiated and agency does not rely on personalised relationships, so that the political elite cannot directly steer economic actors (Schneider et al. 2003: 25). In contrast, authoritarian regimes find it easier to align economic interdependencies with their own needs. This reveals itself in cases of direct state interference within the economic system. However, their potential to effectively react to domestic structural change is lower, as the system often relies on fragile personalised networks rather than on institutions.

We now come to the issue of asymmetry. Relations of interdependence between states are usually asymmetric in some form. While interdependence is generally seen as positive, notably as being conducive to reducing the probability and severity of conflicts between states, asymmetry means that certain types of conflicts will affect states asymmetrically as well. In other terms: for any given asymmetry in bilateral relations, there exists a specific type of conflict which (if not broadened) may affect one state much more severely than the other for a given time horizon. In methodological terms, asymmetric interdependence may be measured by taking into account three variables: “(1) the magnitude of actor A’s interest in or desire for a good (x); (2) the extent of control of x by another actor B; and (3) the ability of A to substitute for x or for B” (Caporaso 1978: 21).

This important aspect may be seen in the case of gas supply disruptions. In the January 2009 gas supply crisis between the Russian Federation and Ukraine, Bulgaria lost an estimated 250 million euros in terms of domestic economic activity. This represents close to 1% of annual GDP for that country over a two-week period, a very substantial economic shock. Bulgaria’s vulnerability was laid bare, as it was unable to substitute for Russian gas supplies in good time, whether from own storage or from other foreign supplies. Overall there is little doubt that both Bulgaria and Ukraine were considerably more vulnerable and suffered considerably more than did Russia. As for the role of political systems, one may seriously wonder whether a liberal democracy would have handled a dispute about prices and payments in such an abrupt manner, and whether the prospect of losing revenue and reputation could have sufficed to encourage a milder and ultimately more reliable course of action.

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<sup>3</sup> Fortunately, political systems that explicitly prohibit exit of population members are relatively rare nowadays, but there exist numerous other barriers which may be erected by contemporary authoritarian systems.

Further cases of asymmetric interdependence, though not related to energy, are revealed in the form of targeted trade restrictions as applied by the Russian Federation to some of its neighbours in recent years, e.g. Georgian and Moldovan wine, Georgian mineral water, Belarusian dairy products. While trade of goods and services between states is an important and attractive form of interdependence, in addition to being mutually beneficial as evidenced by theoretical and empirical economic analyses of international trade, standard international trade theory does not leave policy-makers and analysts well equipped to deal with the analysis of coercive relations between states. In other terms, a specific type of analysis is necessary in order to make sense of a state's economic security needs and its economic vulnerability. In the case of energy supplies, the debate on energy security and energy vulnerability must therefore take into consideration different types of risks and threats, including the possibility of coercive actions on the part of suppliers.

### ***Security of supply vs. security of demand***

Concerns over Europe's security of energy supply are justified. Both oil and gas supplies to EU member states have been disrupted several times in the last few years. It is naturally important to ask how these disruptions occurred, and who was responsible for initiating them. But for the purposes of this paper the focus will be on a conceptual clarification which we believe must be made.

Security of supply is partly a hard security concept. In the absence of security stockholdings and alternative suppliers, an import-dependent country cannot withstand an abrupt and substantial energy supply disruption without suffering immediate and highly debilitating economic losses and societal upheaval, as well as a degradation of national defence capabilities.

Security of (gas) demand as understood by the Russian Federation, on the other hand, relates to longer-term targets in terms of maintaining market shares, steering investment decisions in the gas sector and receiving stable revenues. It is argued that stability of revenues has to be assured as the state treasury depends on hydrocarbon exports. It is, in other words, a concept of budgetary stability, not a hard security concept, as the absence of demand for hydrocarbons on the world market would neither preclude the development of industrialized civilization nor hamper national defence. This asymmetry is particularly strong for short time periods. As pointed out in (Liuhto 2009: 120) : *"[...] due to relatively small emergency storages, the Union needs energy almost immediately but Russia can cope even if the energy-related financial inflows would stop for a longer period"*.

The incoherence of the security of demand argument is further underscored by the fact that Russia applies this concept to gas exports. Total gas exports account for only 14% of the value of total exports of goods from the Russian Federation, while oil exports account for 49% of the total<sup>4</sup>. As a flexible world market exists for oil but not for gas, the EU's ability to substitute suppliers is much higher for oil, whereas it is low for gas. Conversely, Russia's budget depends much more on exporting oil than it does on exporting gas. If security of demand is seen as a right to have stable

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<sup>4</sup> Source: United Nations COMTRADE database; data for 2008 as reported by the Russian Federation to the United Nations. SITC revision 3, codes 33 (petroleum and products), 34 (gas natural/manufactured) and total; exports to all countries of the world including unspecified (confidential) destinations.

revenues then its argumentative basis is quite weak. Firstly, if juxtaposed with the oil sector, the gas sector contributes only a small part to revenues and hence to budgetary stability. Secondly, if Russia wanted to include oil demand into its security claims, the EU is not the right addressee, as oil is regulated by a global market.

As a result, the concept of "security of demand" with respect to gas has a weak basis even in economic terms, and no basis at all in hard security terms, whereas security of supply, particularly from the viewpoint of Central and Eastern European countries, is relevant for both economic and hard security reasons.

### ***Diversification of suppliers vs. diversification of routes***

Diversification of routes without diversification of suppliers, e.g. more pipelines from Russia to Europe but no other changes, is a good idea if the probabilities of supply disruption are independent from one another as well as independent from the actions of either the supplier or the final consumer. In particular, redundancy in supply routes is a worthwhile investment if there is a relatively high probability of failure due to technical or natural causes, or if there is a generally high probability of attack from an external actor, e.g. a terrorist group. In that case, additional transport infrastructure may be worth the investment (depending on the level of threat and the size of the necessary investment). However this is not part of the debate as the probabilities mentioned above are considered (rightly) to be very low.

In fact, the supply route diversification argument rests on the assumption that an entire corridor, i.e. one or more entire transit countries, presents a systemic risk to supplies. If, for instance, it could be shown that Poland repeatedly cuts the flow of gas between Russia and Germany, then the case for the Nord Stream pipeline (designed to link Northwest Russia directly to Germany) would be undisputable. However no such behaviour on the part of Poland (or Belarus) has been observed. There is therefore no energy security argument in favour of Nord Stream.

Concerning South Stream and Nord Stream collectively, the other argument that is touted by supporters of these projects is that Ukraine is not a reliable transit country and that, implicitly or explicitly, Russia is a reliable supplier. However it is debatable to say the least whether Russia is a reliable supplier<sup>5</sup>. Therefore, leaving Ukraine out of the equation would not necessarily improve the situation if Russia is the source of instability to begin with.

Conversely, and in partial defence of Ukraine's position and recent actions, it is not particularly surprising that Ukraine chose to effectively prolong the January 2009 crisis. The only way Ukraine could ensure deliveries of gas to its eastern regions was to withdraw gas from storage located in the West of the country, and operate part of its infrastructure in reverse flow. At exactly the same time, Russia disingenuously announced that it was ready to resume gas deliveries to Europe (deliveries that it had deliberately cut a few days earlier) but that it was unable to do so because Ukraine was refusing to operate its transit system in the normal direction. When Gazprom

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<sup>5</sup> One may cite the International Energy Agency's statement of 16 January 2009 which affirmed that the Russia-Ukraine gas crisis "*casts a shadow over the reputation of Russia as a reliable supplying country for Europe*", along with a number of studies that point out Russia's repeated use of deliberate energy supply disruptions for non-commercial reasons, see e.g. (Larsson 2007: 81).

tried to resume gas flows, it did so by deliberately using only one entry point (Sudzha), knowing that Ukraine would have to block access due to the imbalance in the transit system that this would cause. Then it tried to pin the blame for the failure on Ukraine. Another aspect to consider is that Ukraine is a party to the Energy Charter Treaty and that it has expressed its intention to reform its gas sector in accordance with EU unbundling regulations in the joint EU-Ukraine declaration of 23 March 2009. This would markedly improve the transparency of the sector and integrate it into the EU's energy market. Contrastingly, Russia refuses to ratify the ECT and has further consolidated the role of its integrated monopolist Gazprom.

To conclude, diversification of routes offers no guarantee for European customers that supply disruptions will cease. In addition, a large selection of routes may in fact make supply disruptions more likely. As noted in (Christie 2009: 6), EU demand for imported natural gas will probably increase much less by 2020 than was believed until recently. Notwithstanding the current economic crisis, the core reason is the EU's commitment to climate change mitigation policies, in particular the 20-20-20 Initiative. In other terms, additional pipelines between Russia and the EU will not operate as complements to existing lines, but as substitutes. If that is the case, Russia will be in a position to shift supplies between lines, and supply disruptions will generally be less costly for Russia, and therefore more likely to occur. In addition, the economic benefits of new offshore pipelines are not clear, as they represent more costly options than using existing (or expanded) overland routes.

On the other hand, forcing all supplies through one corridor is the risk-minimising strategy for the European Union, if the risk of disruption is connected to the supplier, not to the transit countries. If both the supplier and the transit country are somewhat to blame, a concerted effort by the European Union to ensure the stability and reliability of the transit country, i.e. Ukraine, is a more cost-effective and less risky option than to allow the construction of transit avoidance infrastructure while leaving Ukraine to its own devices. In this context, the recent efforts of the EU to modernize the Ukrainian gas transit system are a good start.

## **Conclusions**

In this note we show that the arguments of "security of demand" and of "diversification of routes" are asymmetric and ultimately inappropriate responses to legitimate European interests with respect to security of supply and to diversification of suppliers. While the Russian Federation does have understandable commercial and geopolitical ambitions, it is not reasonable to grant them equal legitimacy to conventional economic security concerns as voiced by actors from the EU.

The EU's policy makers should therefore downgrade the importance of both arguments, and focus on the promotion of an energy architecture (both physical and institutional) which is such as to minimise the risks inherent to Russian energy supplies. In particular, diversification of suppliers should be pursued *instead of* diversification of routes. The EU should focus its efforts on conventional (supplier and fuel) diversification projects and on strengthening the stability of existing Europe-Russia supply corridors. As for security of demand arguments, these should be seen as commercial bargaining rhetoric, and treated accordingly.

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