

# Addressing Europe's Energy Dependence on Russia

## Globalizing gas market, creating OECD strategic reserves could make embargoes history

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**Post-war Western Europe was twice the target of energy embargoes, each dramatically altering its energy landscape. A lesson for today is that Europe's present natural gas dependence on Russia can be addressed with a gas policy like that adopted by the OECD for oil in 1973 – one that launched today's collective, market centered, and embargo-proof global oil security system.**

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Russian President Vladimir Putin wrote a letter made public April 10, 2014, warning several EU heads of state that Ukraine must pay its past due gas bill of \$2.2 billion or Russian energy giant, Gazprom, "will completely or partially cease gas deliveries" to the country and be "compelled" to insist on payments one month in advance for any future deliveries – including \$5 billion to refill Ukraine's gas reserves before next winter. Putin frankly wrote: "Undoubtedly,

this is an extreme measure. We fully realize that this increases the risk of siphoning off natural gas passing through Ukraine's territory and heading to European consumers."

No one knows whether Putin will actually cut off gas to Ukraine and thereby to EU states further downstream. What is perfectly clear, however, is that the EU is deeply dependent on Russian gas. Europe simply has no options to replace Russian gas without years-long infrastructure and policy changes.

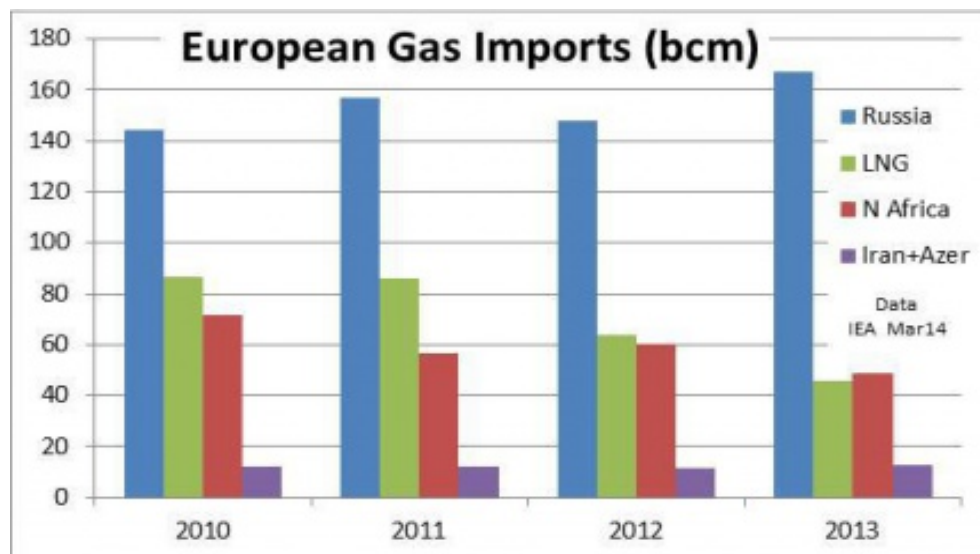
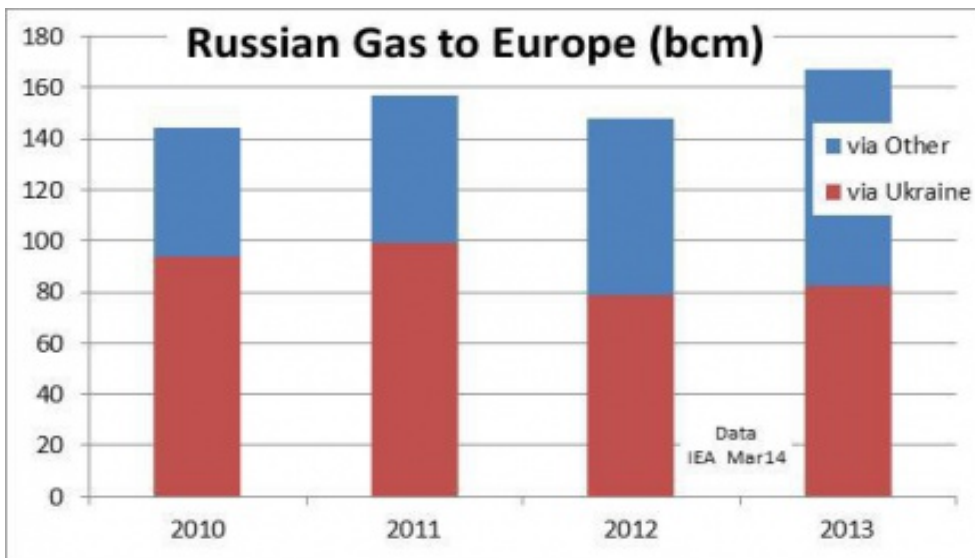


Figure 1. Russia is the predominant source of European imported gas (OECD and non-OECD states).

Figure 2. The majority of Europe's Russian gas imports transit the Ukraine.

EU leaders and US President Barack Obama have made it clear they would impose unprecedentedly severe commercial and financial



sanctions in retaliation for any such embargo. And, if Putin were to end up the loser in such a confrontation, this would devastate Russia's future as an energy supplier. Nevertheless, the extent of the EU's present dependence on Russian gas means it has no energy defense against any concerted embargo. Win or lose, Europe's energy strategy would be dramatically altered.

### Unexpected Outcome: Suez

If this scenario sounds familiar, it should. Similar crises have confronted Europe at least twice since WWII.

Fifty-eight years ago Europe depended on the Suez Canal for **two-thirds of its oil imports** to fuel transport and electric generation. In 1956 Britain and France hatched **a secret plan** with Israel for the former colonial powers to retake the Canal. But, the invading force failed to secure the Canal, and Egypt's President Gamal Abdel Nasser blocked it, cutting Europe's oil lifeline. France and England urgently requested the US use its excess oil production capacity to rescue Europe. However, President Eisenhower had been opposed to any Suez adventure, and demanded the immediate withdrawal of British and French forces. Rather than a rescue, he embargoed all American oil deliveries to France and England – in concert with a Saudi embargo. As their economies ground toward a halt, Britain and France succumbed to Eisenhower's demands.

This humiliating experience sharply altered Europe's long-term energy strategy. Not only did this crisis mark the substitution of US for European power in the Middle East, it brought deep energy strategy changes to Western Europe, including ambitious nuclear energy programs to mitigate energy import dependence, increased use of natural gas, and the development of supertankers carrying sufficient oil to profitably circumnavigate Africa while sailing from the Persian Gulf to Europe, avoiding the Suez choke point.

While these wholly unanticipated Suez Crisis outcomes should give pause to today's EU leaders in the face of abject Russian gas dependence, the 1973 energy crisis offers a more germane lesson for how Europe should address Russia's present embargo weapon.

### Oil Lessons from 1973, Applicable Today

During the 1973 October War, Arab-OPEC states began incrementally embargoing exports to European and other OECD states supporting Israel. During previous embargo attempts by Mideastern producers, Washington had reinvented mechanisms used during WWII, ordering companies to tap spare capacity in Texas and Venezuela to flood the market for allies in need. However, by 1973 Egypt's President Anwar Sadat, and Saudi King Faisal had discovered that, for the first time, the US was pumping oil at full capacity – hence it had no spare capacity to break an embargo. Europe – and Japan and the US – suddenly realized they had no energy respite from the embargo.

When told “objective conditions” obviated any US “oil lift” for Europe, Secretary of State Henry Kissinger **told his staff**, “Then we’ll change the objective conditions.” This rapidly led to the founding of the OECD’s International Energy Agency (IEA) to coordinate energy strategy and the building of an **oil storage system**, the Strategic Petroleum Reserves, to replace the US’s depleted spare capacity. As OPEC states nationalized their oil, private oil majors’ control of prices and delivery ended and unified, global commodity “spot” and futures markets also rapidly emerged.

This **“global barrel”** market-centered system has eliminated oil embargo “weapons” – and has addressed several natural disasters and political supply shocks. Such a system is possible because oil is highly fungible: shortfalls from any producer can be offset by increased supplies from others, all at essentially one world price. Bilateral dependencies between producers and suppliers are eliminated; all oil passes through the global market, shipped by tanker to any buyer.

In the gas sector, a similar system can emerge to replace bilateral, pipeline enforced dependencies if global marketing of liquefied natural gas (LNG), shipped on ocean tankers akin to oil tankers, were to make gas globally fungible.

The EU, locally, has already pushed for minimizing bilateral pipeline dependencies that keep its markets local and empower Gazprom to threaten embargoes, by increasing its storage terminals, pipeline reversibility, and maximal interconnections, requiring gas producers to be decoupled from pipeline owners, and so on. It could also facilitate more gas sources by easing fracking restrictions.

While all of these measures indeed reduce bilateral dependencies, alone they are nevertheless mere palliative measures in the face of Putin’s embargo weapon. While 2014 or 2015 could easily be another 1956, it would be better to take the lessons of 1973 to heart.

What Europe can do – better now than after any embargo – to address the gas embargo threat, is set an OECD gas strategy like that set in 1973 for oil: an intentional drive towards gas globalization, also known as gas internationalization.

This implies urgent mandates for member states to build LNG liquefaction and deliquefaction terminals and specific-sized strategic gas reserves, all freely accessible by a central OECD body with powers to redirect gas in an emergency among member states, as is now the case with oil. So, too, while EU efforts to interconnect and make pipeline networks reversible represent progress, **Brussels' overreliance on** private, market forces to build security-oriented infrastructure, in a gas landscape very different from that of the US, needs to be augmented by vigorous government mandates and supervision to succeed.

Many have advocated US LNG exports to the EU to undermine the Russia’s gas embargo weapon. However, targeting LNG exports to Europe long term is **commercially and geopolitically unrealistic** given much higher prices in Asia and elsewhere. However, with gas globalization – based on a maximum-volume, unified LNG market – any increase in LNG exports sent anywhere in the world would lower everyone’s price and increase everyone’s available supply ... and make gas embargoes as impossible as oil embargoes have become.

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