

Energy Interdependence and Security: Russia and Europe

Prepared for

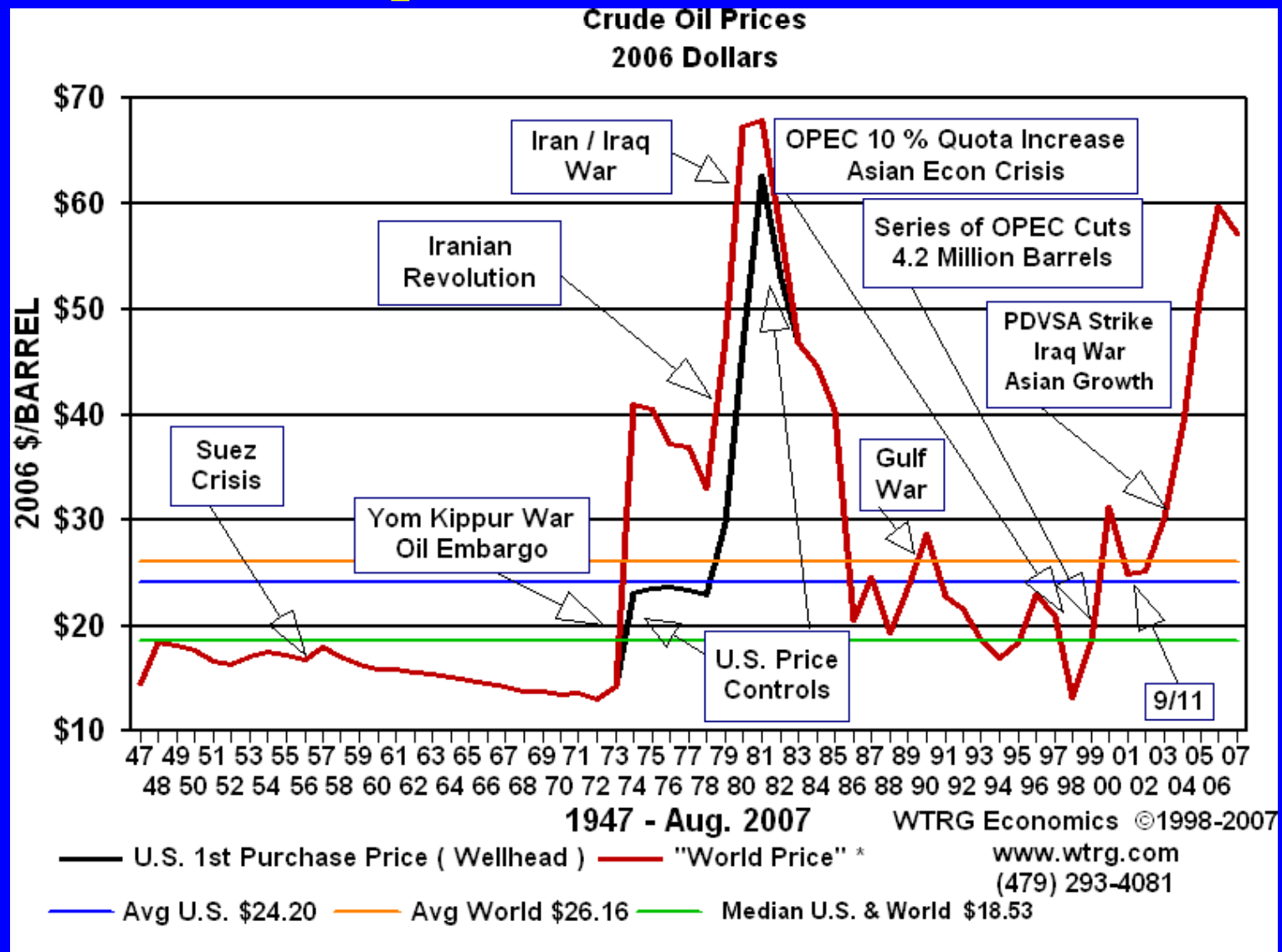
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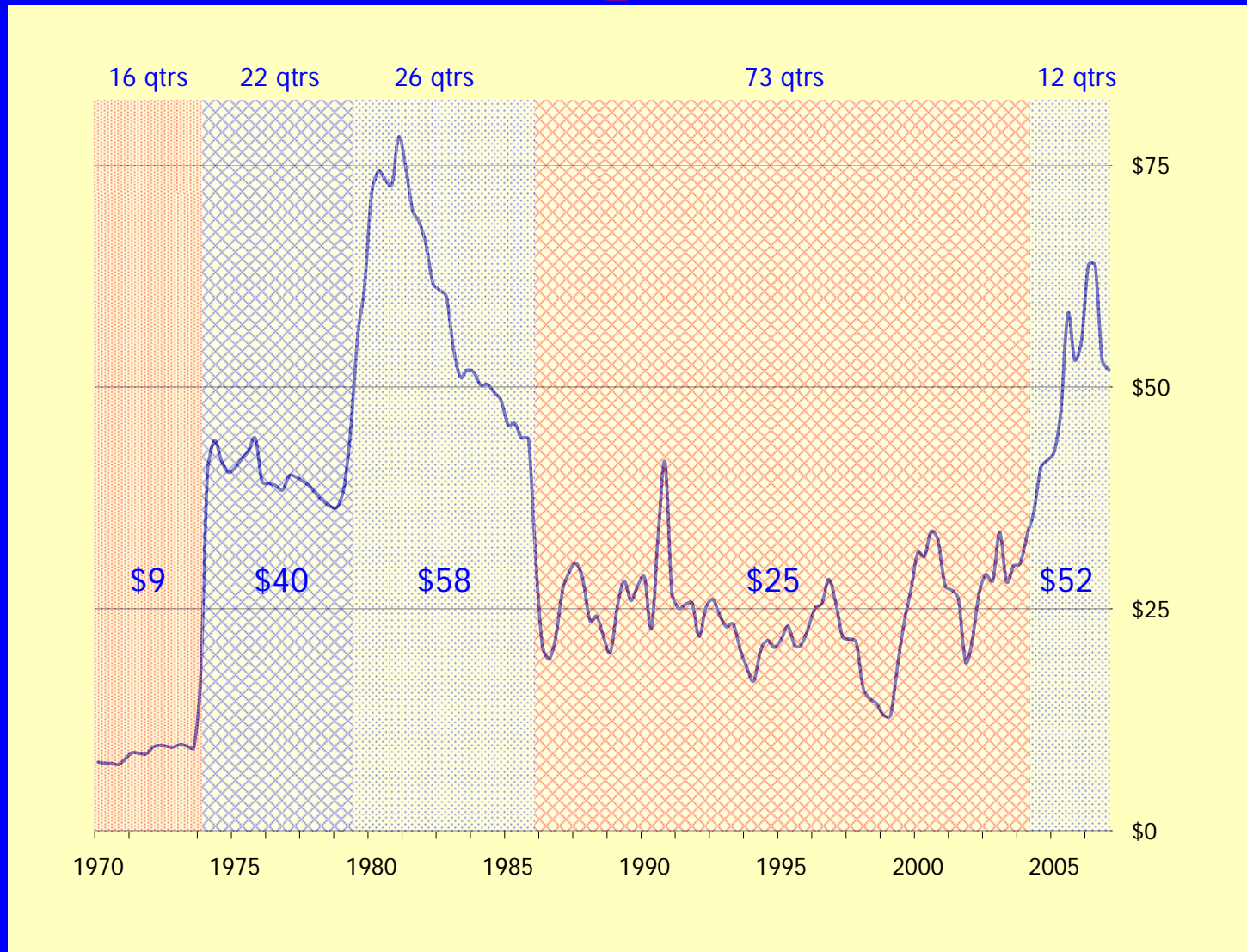
Energy Cooperation or Conflict

- Is there really a possibility for producer-consumer cooperation in energy?
 - Producers and consumers → opposing interests
 - Consumers want low prices, producers high prices
 - Solution, compromise? Median price, average price?
- Price volatility is extreme

Historical Perspective on Oil Prices



Real Oil Prices, periods



Bottom Line on Price Cooperation

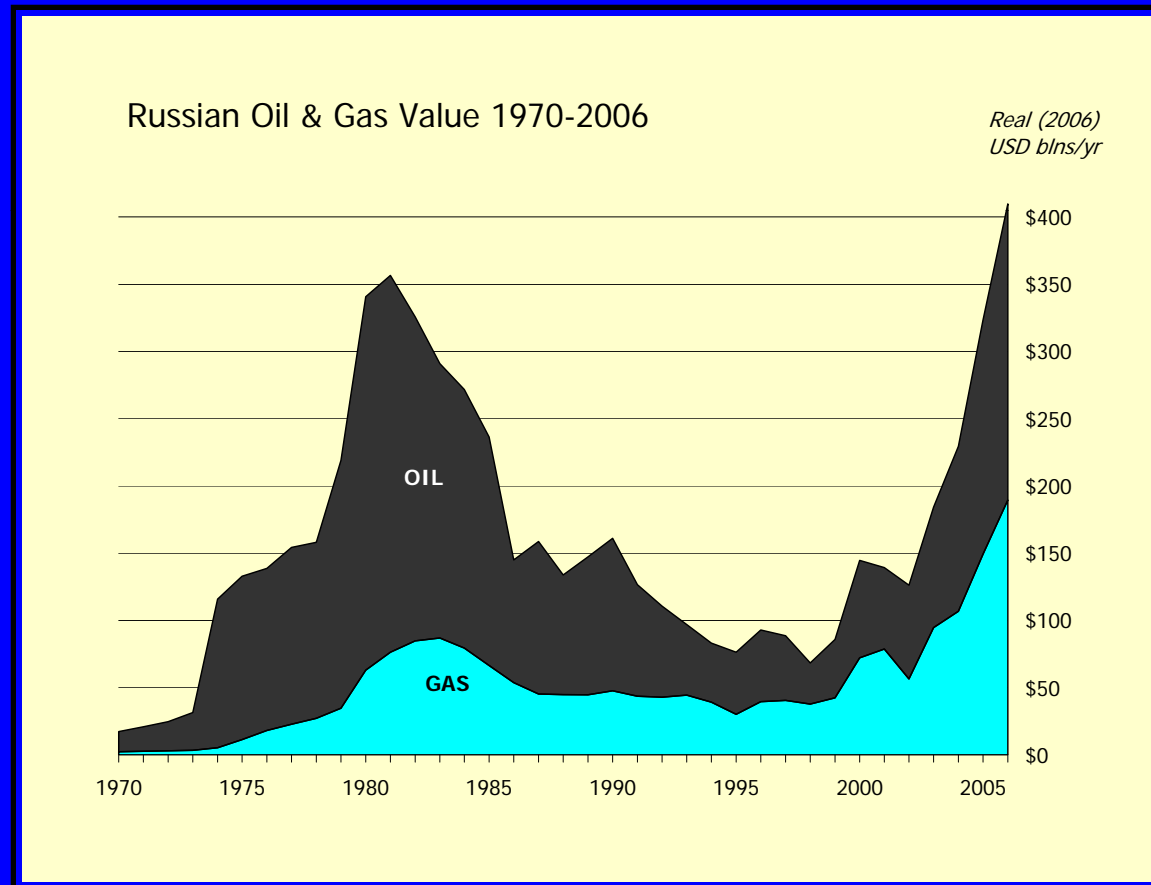
- So intrinsically at odds with West regarding oil price
 - Security of energy supply is non-starter

Real Issue

- Energy flows from Russia to west
- Wealth flows from west to Russia
 - Key problem for both sides is how to deploy the wealth
- Europe's dependence on Russia is a fact
 - Key issue is,
 - How should Europe (and US) formulate its dependence?
 - Is it better to be debtor or equity partner?

Russia's Problem (1): The Oil

- High cost producer of oil, lacks market power
- addicted to oil rents



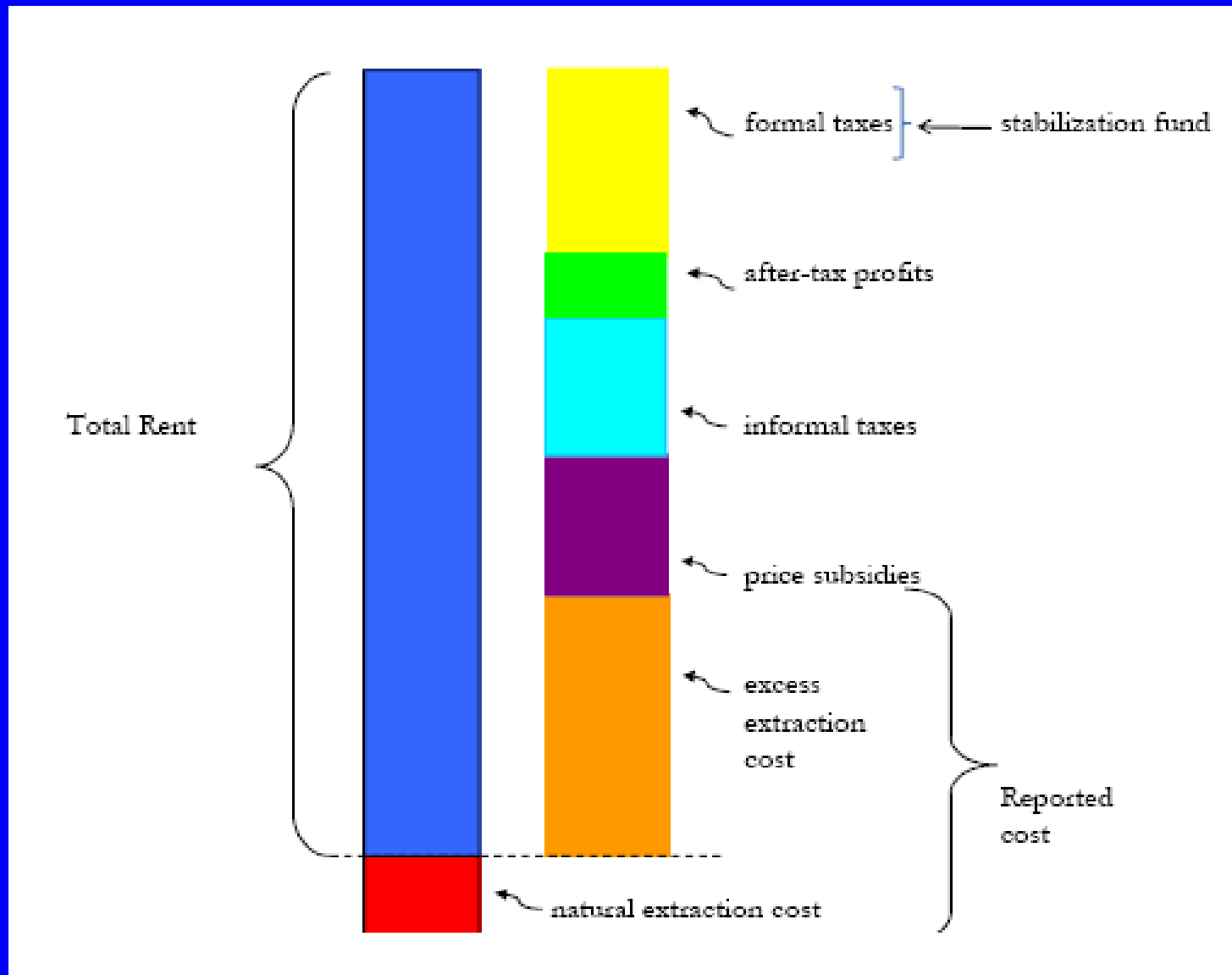
Russia's Problem (1)

- Russia addicted to oil rents
 - Therefore, Russia needs high prices to persist
 - Russian investments in future supplies are contingent on high prices
- But high prices not a certainty
 - Therefore, need to share risk
 - i.e., diversify investments in new deposits

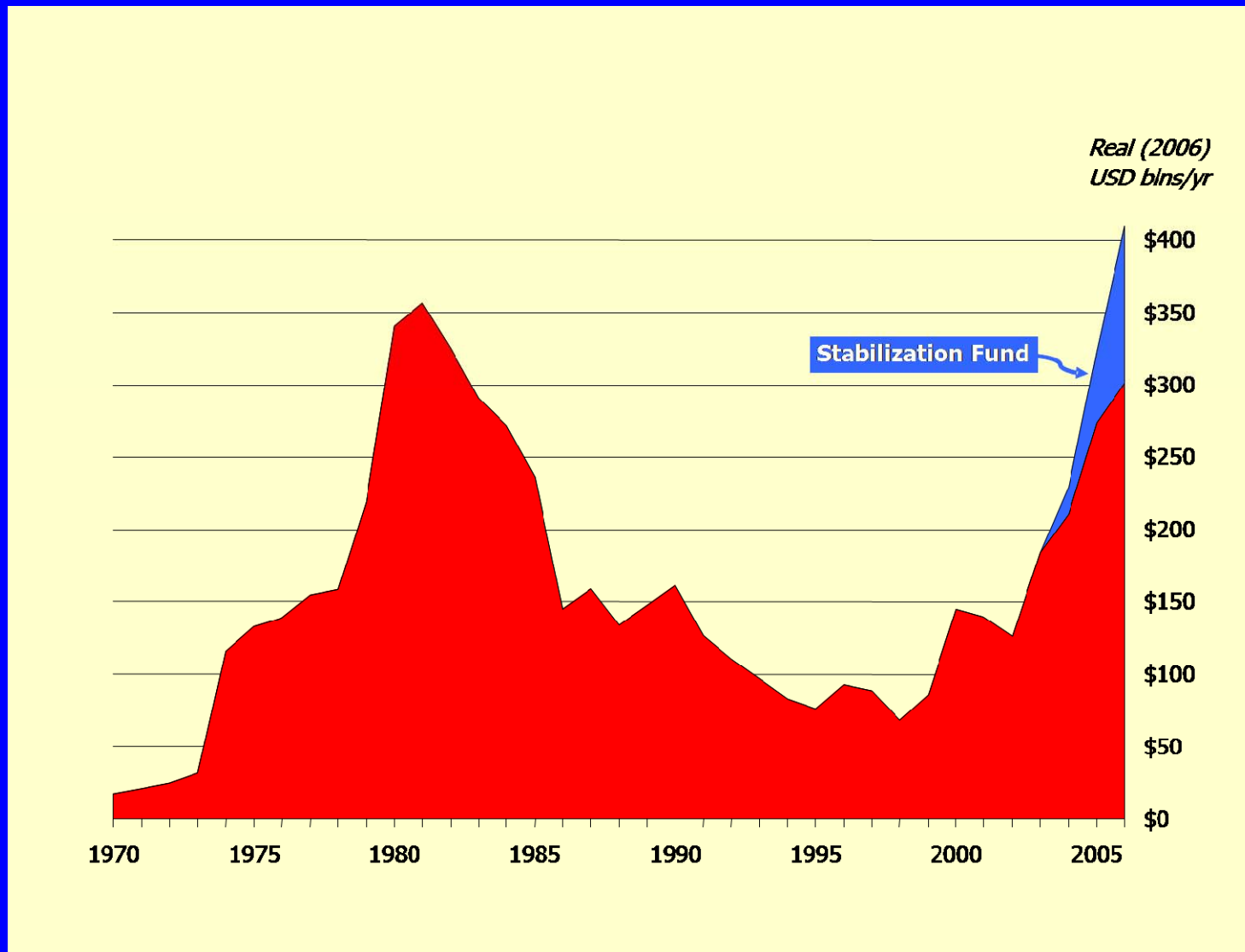
Russia's Problem (2): The Wealth

- Russia has to solve problem of what to do with its wealth
 - Keep it internally
 - Domestic investment too low a return
 - Stabilization fund filled with securities
 - Low return and Financial terror
 - Stabilization fund too small to compensate for decline in rents

Rents and the Stabilization Fund



Rents and the Stabilization Fund



Russia's Problem (2)

- Sovereign wealth fund and ownership
 - Higher returns on investment
 - Stake in western economies
 - Western participation in Russian energy investment

Russia's best policy

- Russia's self-interest is equity approach
- Europe's participation in Russian energy makes it win-win
- Problem is, countries may not act in their own economic self-interest
 - Fear is, Russia wants to dominate

Cooperation

- US case
 - Concern over foreign ownership, e.g., China
 - But the cause is US deficit
- Europe must buy from Russia
 - Is it worse to have Russia invest the surplus in European assets?
 - Equity can modify behavior, promote cooperation
- Easier ways to cause trouble than misusing one's own assets

What Should Europe Do?

- Equity Approach is still best
- Pessimist argues Russia intends to dominate
 - If so, being in debt is worse than being a partner
- Optimist argues Russia not a monolith
 - Voices inside Russia for economic self-interest
 - If so, equity approach bolsters those forces

Bottom Line

- Encouraging Russia to use its wealth to take an ownership stake in Europe's economy is the best policy for Europe as well