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INSIGHTS

Russia-Ukraine Tensions Intensify European Energy Crisis

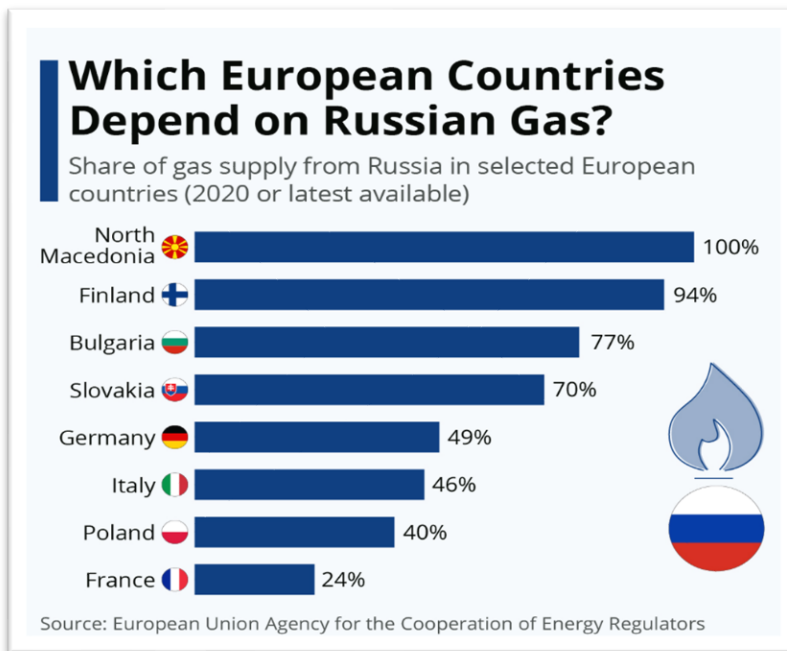
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16 Feb 2022

1. BACKGROUND

As the risk of war between Ukraine and Russia escalates, the energy crisis of Europe has intensified. Russia has gathered around 100,000 troops near the border of Ukraine. Many countries have warned their citizens to leave Ukraine, considering the security risks. Although Russia has claimed to have no intention to invade, the standoff at the border has caused a significant stir in the European energy crisis.

The energy requirements of Europe have always been hard to suffice. Due to the cold climate, most eastern and central European countries have high energy requirements, and without the natural gas from Russia, these countries would have a hard time surviving. The deepening tensions with Europe's largest gas supplier have added fuel to the fears that the Kremlin may restrict its energy exports to the continent in the face of potential sanctions.



Russia supplies 30% of its oil and 35% of its natural gas to Europe, and if there is any escalation in the conflict, it can lead to this being cut-off. It can lead to a surge in oil prices to \$125 for a barrel, with gas prices soaring even higher. In 2020, an average European household faced electricity and gas bills of around €1,200 and in 2022 of €1,850. The surge in the price of natural gas has led to soaring heating bills across the continent.

The ongoing conflict could potentially carry a heavy economic impact on Europe. European economies can suffer if a severe sanction is imposed, keeping countries in the EU bloc from taking decisive action.



2. HOW IS THE RUSSIA- UKRAINE CONFLICT AFFECTING THE EURO- ENERGY CRISIS?

There are various ways that a new Russia-Ukraine conflict might affect the European energy supplies.

- Considering an annexation of Ukraine were to take place, both parties could suffer infrastructural damage. It would disrupt the main gas pipelines running across Ukraine. These pipelines carry around 13% of the total energy imports to Europe, along with the southern branch of the Druzhba oil pipeline, which runs through Belarus and western Ukraine and into Slovakia, Czechia and Hungary.
- If the conflict were to escalate further, Russia could intentionally cut supplies due to military-political tensions. Assuming the Kremlin goes ahead with this scenario, it would also impact gas supplies from Belarus to Poland. It would also affect the Nord Stream pipeline under the Baltic Sea, terminating in Germany.
- The new Nord Stream 2 (NS-2) pipeline also plays a role in the energy crisis. The NS-2 is 'technically' ready. However, it is yet to receive legal approval from Germany to initiate gas supply. It would affect the Ukrainian economy as the transiting gas fetches them \$2-3 billion each year. Although, Russia is not planning to extend the gas transit contract with Ukraine after 2024, following the cessation of the deal between Naftogaz and Gazprom. The Ukrainian worry is reasonable as Russia is trying to bypass Ukraine to debilitate the state and gain more influence in the continent. The evidence for this is Russia's readiness to replace the existing system instead of repairing the old one for half the costs. Russia shelling out millions of dollars in laying out NS-2 is an unmistakable indication of eliminating Ukraine.
- Yet another way this could stoke the energy crisis is through sanctions. As a response to the Russian military stand-off in Ukraine, Europe, and the United States will have no option but to impose sanctions, thwart investments, and prohibit dealings with prominent financial institutions. It can assist Russia in terminating the energy supply to Europe.

EUROPE - RUSSIA CO-DEPENDENCY

It is critical to recognise that Russia relies on Europe for its considerable gas market. Around 75% of Gazprom's (Russia's state-owned gas giant) revenue is the product of the oil and gas exports to Europe. Gazprom needs these gains from its European clients to deliver gas at a lower rate to its domestic consumers. The Oxford Institute for Energy Studies (OIES) estimates gas exports amount to 6% of Russia's tax revenue — a significant amount of income for the Russian government. Hence, it could be detrimental to the Russian economy if it were to shut off its valves.



Energy As A Weapon

- Russia is weaponizing gas by holding back supplies despite the soaring fuel prices across Europe.
- An example of how the Russian government wields its 'energy weapon' less blatantly than simply cutting off the supply, were evident in the negotiations of Oct 2006, by the Russian Prime Minister with his Ukrainian counterpart

In Oct 2006...

There was a negotiation between Russia and Ukraine to keep the price of gas below \$130 per 1,000 cubic meters. During this negotiation, Ukraine agreed to 4 concessions:

1. Postponing any referendum on NATO membership,
2. Agreeing to the terms of leaving the Russian black sea fleet in Sevastopol until 2017 and perhaps even extending the lease,
3. Continuing to use RosUkrEnergo as transit partner for another five years, and,
4. Agreeing to receive Turkmen gas through Russia only.

3. CURRENT GLOBAL RESPONSE



"We are not using any weapons. Even during the hardest parts of the Cold War Russia regularly has fulfilled its contractual obligations and supplies gas to Europe"

President Putin



"In order to fulfill the concerns of everybody, the only way is speaking on the table and discuss. If there is a war between Russia and Ukraine, Nordstream 2 would not become operational"

EU's Top Diplomat Josep Borrell



"In the event of a military aggression against Ukraine that threatens its territorial integrity and sovereignty, that will lead to tough sanctions that we have carefully prepared"

Germany's Chancellor Olaf Scholz



4. ASSESSMENT

The cost of dependence on Russian gas is becoming glaringly obvious. Russia's dominant position in European gas markets presents a grave threat to the political sovereignty of the EU, especially the former Soviet states that are entirely dependent on Russian gas. The economic sanctions are going to be difficult for Europe to stomach.

Depending on Russia to suffice its energy requirements is a risky position for Europe as it could weaken its energy sector. It then becomes crucial for Europe to look for alternative options. These include:

- Germany, and other west European nations, relying heavily on Russian gas, need to shift to Norway, the Netherlands, Britain, and Denmark for gas imports.
- Southern Europe can suffice its natural gas needs by Azeri gas via the Trans Adriatic Pipeline going towards Italy and the Trans-Anatolian Natural Gas Pipeline (TANAP) running through Turkey.
- European countries can check various non-gas options that are available. These could include power imports via interconnectors from neighbouring countries or increased power generation utilizing hydropower, nuclear, renewable sources, and coal, among others.
- The EU could also expand their electricity storage, hydrogen power, and renewable energy to replace the Russian gas supplies.

5. CONCLUSION

Sanctions can be a double-edged sword that often affects the countries that impose them as much as the target of their sanctions. Russia stopping the gas export would be highly unlikely. But the lesson from the ongoing crisis should be that Europe needs to find alternate options of sustaining its energy requirements, accelerating decarbonisation and reducing the amount of natural gas consumed. Europe should, therefore, focus on achieving efficient and better energy security for the foreseeable future by diversifying its energy supply and reducing energy dependency on Russian supplies.



ABOUT THE AUTHOR

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Prepared at the Risk Assessment and Analysis Centre, Bangalore

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