

POLICY BRIEF

RECOMMENDATIONS
FOR THE NEW
ADMINISTRATION

Gas Geoeconomics: A Strategy to Harden European Partners Against Russian Energy Coercion

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This brief is part of a series of policy recommendations for President-elect Joe Biden's incoming administration. Focusing on a range of important issues facing the country, the briefs are intended to provide decision-makers with relevant and effective ideas for addressing domestic and foreign policy priorities. View the entire series at www.bakerinstitute.org/recommendations-2021.

EXECUTIVE SUMMARY

- The expiration of many Central and Eastern European (CEE) firms' long-term natural gas supply contracts with Gazprom creates a *window of opportunity* for this administration to provide strategic financial support for specific key gas infrastructure projects—a policy we dub “gas geoeconomics.”
- U.S. backing can accelerate the construction of vital pipeline interconnections and liquefied natural gas (LNG) import options throughout the region, allowing CEE countries to import gas from a greater range of sources, foster deeper *market liberalization*, and dis-incentivize future long-term gas supply deals with Russian firms.
- This in turn would blunt Russia's ability to use gas as an instrument of strategic leverage, afford allied governments greater latitude to confront Russian malign activities, and enhance key European partners' *resilience against Russian energy coercion* for decades to come.

- In addition to the security benefits, promoting gas market liberalization would also create a more level playing field for *competitive trade* and generate new opportunities for private firms, including those from the U.S.

THE THREAT

Russian energy supply entities generally operate as fundamentally commercial actors. But under certain circumstances these firms can be—and have been—utilized as instruments of coercive influence acting on behalf of the Russian state.¹ Our previous research identified at least 22 discrete instances since 1990 where Russian entities used price and/or physical volume manipulation of crude oil or natural gas supplies—often amid political tensions—to pressure consumers located in Central and Eastern Europe (CEE) and the former Soviet countries.²

The CEE is especially vulnerable to such machinations given the dominance of Russian gas in this region that stems from continued reliance on Soviet-era pipelines, which reduce connectivity with the EU's West and generally



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exclude non-Russian gas supply sources. This dependence directly affects U.S. security interests: consider, for instance, Ukraine's rejection of a 2013 association agreement with the EU amidst Russian pressure exerted in part through gas pricing.³

GAS GEOECONOMICS OFFERS A POLICY SOLUTION

Yet the tyranny of legacy and installed infrastructure can be flipped in an act of energy security jiu-jitsu. Circumstances now present Europe with just such an opportunity to invest in supplemental gas pipelines, import terminals, and other facilities to rewire the regional gas infrastructure, diversify inbound gas supplies, and defang Moscow's ability to use them as a coercive instrument.

In Europe, this effort is already underway—witness the EU's energy sector "Projects of Common Interest" (PCI) list.⁴ Nevertheless, selected financial "nudges" from the U.S. can help get projects completed (and security enhanced) sooner. In this context, geoeconomic actions (i.e., using economic instruments to produce beneficial geopolitical results) can offer a minimum cost, maximum payoff for U.S. policy in the region. It is a path to providing political and energy market resilience against any potential use of natural gas for political or economic means by the Russian state that could undercut the energy security of our allies in CEE, all of whom are also either North Atlantic Treaty Organization (NATO) members or NATO partner countries.

GAS GEOECONOMICS IMPLEMENTATION MEASURES

Physical infrastructure projects can be facilitated through several interrelated financial support options:

Option 1: Provide U.S.-backed "forgivable debt" to finance EU gas infrastructure projects.

Provide loans backed by a consortium of interested countries to support time charters of floating storage and re-gasification units (FSRUs) and construction of essential

associated connective infrastructure to get gas into local pipeline networks. *If within a pre-negotiated time frame the host country adopts and implements reforms aimed at fostering gas market liberalization, the debt could be forgiven.*

Implementation could be measured on the basis of a number of metrics including but not limited to: (1) lifting price controls; (2) physical unbundling of gas production, storage, and transmission infrastructure; (3) the emergence of verified, market-based trading of pipeline capacity; (4) verified, nondiscriminatory third-party access by non-Russian controlled entities to gas pipelines in the country; and (5) trading turnover rates at virtual transfer points or gas hubs associated with the host country's gas pipeline network.

Option 2: Provide "assured payback" from the U.S. government to private import project developers.

The initial investments would be made with private capital, but if a mutually established rate-of-return target was not met within a prescribed timeframe, U.S.-facilitated funds could be used to compensate the developers for the difference between actual returns and the minimum return negotiated at the project's inception.

Option 3: Provide preferential project finance loans.

This could be done at London Inter-bank Offered Rate (LIBOR) or LIBOR + 50 basis points and/or by allowing U.S. and EU-affiliated financial institutions to take a larger lending role than is typically the case. Such an approach could be especially useful for projects aimed at initiating the liberalization process in a particular country and showing capital markets that the jurisdiction is being "de-risked" from a gas sector investment perspective.

The positive effects of U.S. involvement could be almost immediate and could help tangibly demonstrate American commitment to multiple European partner states while also helping install the physical hardware needed to underpin European gas security for decades to come.⁵ Moreover,

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geo-economics can complement and ensure the effectiveness of current U.S. initiatives in the region, such as the Department of Defense's European Deterrence Initiative.⁶

THE GAS GEOECONOMICS CONCEPT HAS ROBUST BIPARTISAN SUPPORT

Gas geo-economics concepts find increasing acceptance in both houses of Congress and on a bipartisan basis. In April 2018, the authors published a working paper titled "Gas Geo-economics in Europe: Using Strategic Investments to Promote Market Liberalization, Counterbalance Russian Revanchism, and Enhance European Energy Security." By October 2018, Sen. Chris Murphy, D-CT, had introduced Senate Bill 3585, the "European Energy Security and Diversification Act of 2018," whose core content tracked the authors' novel gas geo-economics policy concepts almost word for word and country by country.⁷ The 2018 bill evolved into Senate Bill 704 (the "European Energy Security and Diversification Act of 2019") and a House companion bill, H.R. 1616 (introduced by Rep. Adam Kinzinger, R-IL), which passed the House in March 2019 by a vote of 391–24. The bill has been received in the Senate, read twice, and referred to the Committee on Foreign Relations.⁸

Increasingly bold Russian malign activities across Europe over the past several years—be they an attempted coup, influence operations, or assassinations (or attempts thereof) that involve use of internationally outlawed chemical weapons—make increased energy resilience an urgent strategic priority. We urge the administration to rapidly engage with Capitol Hill while also taking executive actions to rapidly identify and implement multiple gas geo-economics projects. If it does so, 2021 can be a year when the U.S. can empower its European allies standing on the frontlines of Russian revanchism while simultaneously creating new markets for U.S. LNG to compete in.

ENDNOTES

1. Indeed, a 2018 European Parliament report found that "through state-owned Gazprom and Rosneft, Russia has shown a willingness to abuse its dominant market position in support of foreign policy goals, primarily in its immediate neighbourhood but also further afield." European Parliament Policy Department for External Relations, Directorate General for External Policies of the Union, "Energy as a tool of foreign policy of authoritarian states, in particular Russia," PE 603.868, April 2018, [https://www.europarl.europa.eu/RegData/etudes/STUD/2018/603868/EXPO_STU\(2018\)603868_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2018/603868/EXPO_STU(2018)603868_EN.pdf).

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3. "Ukraine protests after Yanukovich EU deal rejection," *BBC*, November 30, 2013, <https://www.bbc.com/news/world-europe-25162563>; see also Ivan Nechypurenko, "Putin Wins Over Ukraine With Gas Deal and \$15Bn Bailout," *Moscow Times*, December 17, 2013, <https://www.themoscowtimes.com/2013/12/17/putin-wins-over-ukraine-with-gas-deal-and-15bln-bailout-a30605> (Russia cut gas prices to Ukraine by one-third to help Yanukovich shore up political support in the Eastern industrial region).

4. "Technical information on Projects of Common Interest: accompanying the Commission Delegated Regulation (EU) 2020/389 final of 31 October 2019 amending Regulation (EU) 347/2013 of the European Parliament," European Union, March 2020, https://ec.europa.eu/energy/sites/ener/files/technical_document_4th_pci_list.pdf.

5. Gabriel Collins and Anna Mikulska, *Trans-Atlantic Gas Diplomacy 2.0: Molecule-indifferent Gas Geoeconomics, Not Energy Sanctions, are the Best Option to Harden Europe Against Russian Gas Coercion*, (Houston, Texas: James A. Baker III Institute for Public Policy of Rice University, 2020), <https://www.bakerinstitute.org/media/files/files/441a118e/ces-pub-gasgeoeconeurope-100120-3.pdf>.

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7. U.S. Congress, Senate, European Energy Security and Diversification Act of 2018, S. 3585, 115th Congress (2017–2018), <https://www.congress.gov/bill/115th-congress/senate-bill/3585/text?q=%7B%22search%22%3A%5B%22central+europe+Energy+Security%22%5D%7D&r=56&s=4>.

8. U.S. Congress, House, Actions Overview, European Energy Security and Diversification Act of 2019, H.R. 1616, 116th Congress (2019–2020), <https://www.congress.gov/bill/116th-congress/house-bill/1616/actions?q=%7B%22search%22%3A%5B%22European+Energy+Security+and+Diversification+Act%22%5D%7D&r=3&s=1>.

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