Russia As a Key Partner for Europe

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Russian view on the EU energy policy: major problems

- Detraction of the role of gas
- Unclear signals on the future gas demand
- Fast regulatory changes which frequently ignore the interests and positions of producers
- Incoherence of two European goals: to decrease Russian gas import dependency and to develop strategic partnership with Russia
- EU washing hands of transit problems
Detraction of the role of gas

- Emphasis on renewable energy should not be overestimated, as gas is the best and economically most attractive option for transition to the low-carbon economy.

- Energy policy scenarios with strong emission constraint and focus on non-fossil energy (like the IEA-2009 pessimistic view on role of gas with coal renaissance, EU-2009 press on biomass and EU-2010 press on wind) doesn`t take into account the economic impact of these scenarios on consumer prices; role and scale of subsidies; degree of certainty on technological shifts etc.

- For some reasons in the EU strategic documents natural gas is not given a fair place in the future fuel mix
Unclear signals on oil and gas demand

- In the EU at present there is considerable uncertainty regarding future projections of oil and gas demand. Comparison of more than 40 European energy scenarios, presented in Moscow, shows a huge uncertainty and extremely wide range of forecasts which are resulting in a large range of uncertainty in future import requirements, discouraging investments and undermining security from the producers’ perspective.

- In the short term there is a risk of producing countries under investing because of the uncertainties created. Investments in major gas infrastructure needed to increase the overall level of security of supply on a regional level are capital intensive and take years of planning to complete, decisions that are delayed now will have impact in the future.

- In the longer term these signals will make producers investing in the infrastructure for oil and gas exports to the other regional markets.
Comparing EU gas balance projections by 2020, mtoe

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<th>Scenarios</th>
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HOG = High oil and gas prices; for ENTSOG - 2019
Comparing projections of the EU gas demand growth rates in 2009-2020

[Diagram showing the growth rates of EU gas demand projections from various sources, with the y-axis showing growth rates from 0 to 3.5 and the x-axis listing different sources such as PRIMES-Ref, IEA-Res, RES-2020-RES, etc.]

6
Fast regulatory changes without consultations

- Fast European regulatory changes (1st, 2nd and 3rd Liberalization Packages and many other decisions) frequently ignore the interests and positions of producers.

- Producers, who are investing billions in the new infrastructure and production, are presented with a fait accompli without any discussion of the possible consequences (which could be negative for the EU as well)
Incoherence of two European goals concerning Russia

“The EU should reduce its energy dependency on Russia but the EU should not back out of the mutual partnership”

Is it possible to build a consistent policy based on these two conflicting goals?

Goal 1: promoting the strategic relations with Russia
Action plan:
- Upgrade projects with Gazprom participation up to T-E-N level.
- Consider gas projects circumventing Russia on commercial basis.
- Treat the EU solidarity principle as the right for any member state to buy Russian gas.
- Assure security of demand for Gazprom.
- Make broader use of natural gas in the EU’s energy mix as the cleanest fossil fuel.

Goal 2: decreasing the dependency on Russia
Action plan:
- Downgrade projects with Gazprom participation in the EU’s priority list.
- Award gas projects circumventing Russia with public finance in case of insufficient private support.
- Promote “team spirit” with Russophobic minority in the EU.
- Speak with one “tough” voice with Gazprom on energy matters.
- Subsidize any energy sources alternative to natural gas for security reasons.
There is no economic reason to discriminate against Russian gas

- Gazprom’s role of dominance in the EU market is highly exaggerated (23% of EU gas consumption, compared with the fact that 33% of EU oil consumed is coming from Russia).

- Prices for Russian gas are on par with its competitors’ oil-indexed prices.

- European customers are perfectly protected by long-term oil-indexed contracts against any form of monopoly abuse of power.

- With long-term contracts in place any form of OPEC-style cartel in gas is impossible. It is a European buyer, not a supplier, who defines daily volumes within the range provided by the contracts (DCQ).

- Presence of Gazprom’s affiliated companies in Europe only increases market liquidity and competition.
EU’s reaction to the January 2009 transit crisis was reactive and not proactive. EU failed to use its enormous political muscle to persuade Ukraine not to revert to transit blackmail or to undertake any other actions to solve the problem.

- In March 2008 Gazprom partially cut-off supplies to Ukraine demanding payment for previous deliveries. The Ukrainian company responded: "Naftogaz can only guarantee uninterrupted transit of gas to European consumers as long as it does not threaten Ukraine's energy security".

- The EU Energy Commissioner Andris Piebalgs identified a "real threat" to the EU supply but preferred not to notice transit blackmail. Without going into detail, Piebalgs blamed both sides for escalation of a “commercial” dispute and called for development of the EU’s common energy market.

- The situation could have been changed if the European Commission had taken a different approach, act in accordance with the proclaimed principles. It could proactively warn Ukraine that transit blackmail is unacceptable for a country aspiring to Eastern Partnership and to EU membership. This would have cost nearly nothing, but was done neither in December 2008, nor in January 2009.

- Russian Government and Gazprom warned EU of a transit crisis threat on a number of occasions but Commission ignored this. It abdicated from its responsibility to step in claiming that it does not interfere into a commercial conflict which was clearly not a case.
In December 2008, the “price” dispute between Gazprom and Naftogaz was not over
market price, but over the size of the subsidy that Ukraine was demanding from Russia.
Historically, Russia has provided Ukraine with subsidies through below market price gas
that have reached astronomic levels.

If EU was operating in the spirit of true partnership, it would have advised Ukraine that
Gazprom was not obligated legally or otherwise to provide subsidized prices on gas. This
would have contributed to a solution to the January crisis before it came to a head.
Dealing with the transit problems: unworkable approach

Ukraine had refused the Russian sales contract and therefore was officially not receiving any gas for its domestic market, but was contractually obligated to transit Russian gas to European customers. EU and Energy Charter Secretariat have not reminded Ukraine of this obligation when the Ukrainian court on January 5th declared the transit contract with Russia null and void.

Meanwhile EU developed a “perfect” excuse not to take responsibility for the crisis settlement exhibited by Vaclav Bartuska, the Czech Ambassador-at-Large for Energy Security in May 2009:

"Gazprom is under the contractual obligation to sell its gas at the EU border, how you [Russia] deal with Ukraine is your problem and yours alone. This January you've tried this trick already, we refused to pay for it. We paid a fair price at the EU border and you'll have to deal with Ukraine yourself. Good luck,"
With regard to the recent gas crisis, the European Commission is not in a position to take sides, in particular because we are not acquainted with all contractual obligations of the sides.

Heinz Hilbrecht,
Head of the Gas Coordinated Group, a body which advises the Commission on gas supply issues.

“We have no proof that Ukraine took away gas illegally,”

Andris Piebalgs

Once the dispute was finally settled, the EU’s verdict was the following – “We do not know exactly who is responsible, and we are not interested indeed in finding this out, but we believe that supplies from Russia are insecure” instead of trying to draw a lesson from this situation.
Transit threats

- Regarding transit states inherent problems exist in the fact that the gas that is exported from Russia has to be transited across some states that can be, at times, unreliable.

- Belarus remains an important partner for Russia in its role as a transit state, although the relationship has ranged from exceptionally close to open hostility.

- Obviously the risks that are inherent in the transportation of gas through the Ukraine have been somewhat mitigated by the recent election results. The threats identified from such transit of gas through the Ukraine are threefold
  - there is a threat of the potential risk of a physical rupture of the transit via the Ukraine territory
  - there is the threat of a monopolistic behaviour in relation to the transit fees and transit terms in general
  - a country can fail to deliver on the whole volume of gas entered on the border with Russia to border with the EU

A continued threat for the EU remains in the form of commercial disputes such as that which Russian and the Ukraine had in 2009. The lack of a firm enforceable legal contract between the countries regarding the gas and the inability to reroute the gas transferred through the Ukraine means that such a threat cannot be ruled out in the future and should be identified as a principal area of concern for the EU.
General recommendations from the Russian stakeholders

- The most important is to ensure the demand security that will guarantee the cost-effectiveness of the supply and transport investments.

- It is necessary to develop road map of EU-Russian cooperation in all energy sectors in the long-term until 2050 with the emphasis on energy security. One of the major targets is to get a clear vision for both sides of their future expectations. There should be cooperation of EU, Russia and World experts at permanent base with proper governmental support to evaluate scenarios and harmonize the forecasts.

- It`s necessary to have an open discussion of the possible impact of the regulatory changes on the supplier`s business (like the EU-Russia joint working group on the 3d Package). There should be also a platform for EU-Russia regulators and system operators to solve some issues (especially for the Baltic states)

- EU should review the validity of its major policy goal of decreasing dependence on Russian gas. There is no evidence of such a threat. Diversification of the energy supply portfolio for the EU should result from market drivers and not from political drivers.
Security of Demand:

- Long-term contracts
- The possibility of downstream investment (including some upstream-downstream reintegration of the industries with cross investments in common projects or joint ventures)
- Clear EU signals and policy on natural gas
- Consistent external infrastructure policy
- Protection of the investments in the infrastructure
- Focus on ensuring stable transit
Recommendations from the Russian stakeholders on oil

- The EU should aim at mitigating the danger of closure of the Turkish Straits by creating conditions and facilitating investments for the commercial development of pipeline by-passes (including Burgas-Alexandroupolis, BPS-2).

- The unsatisfactory functioning of the international oil markets and the resulting uncertainty and volatility in oil prices is the main security threat for future oil supplies. Russian proposals to reduce this artificially increasing volatility are:
  - To reduce the role of traders in favor of direct contracts between oil producers and consumers
  - To develop new oil trading system with switching to long-term supply contracts; setting new trading floors in the producing countries; increasing the number of markers in the oil market
  - To set up inventories in producing countries
  - To coordinate tax policy (harmonizing the fiscal burden on oil-producing companies)
  - To increase the role of producers by involving significant non-OPEC producers in the effort to stabilize markets – such as Russia, Kazakhstan, Azerbaijan, Norway, and Brazil
  - Vertical reintegration and reciprocity could also help. Specifically, the national oil companies of major producing countries should be allowed to invest downstream in the European markets establishing their own distribution networks, so as to acquire direct access to the final consumer, in the same way as European firms should have the same possibility in producing countries.
Recommendations from the Russian stakeholders on natural gas

- Security of demand requires the EU to provide clearer signals regarding future gas demand in Europe to facilitate investment both internally and externally. The EU should therefore develop a gas demand forecast which is based on the amalgamation of energy policies and individual national plans.

- The process of the continued liberalisation of the EU's markets is not yet fully realised and there is a pressing concern about going ahead with these measures to ensure long term security in gas supply. Regulation should be clear and facilitate the market in investments, not stop them.

- The development and strengthening of early warning and transit crisis prevention mechanisms at the EU level should be encouraged.

- The possibility of an independent transmissions operator in the Ukraine composed of Ukrainian, EU, and Russian operators should be seriously evaluated. Such cooperation could significantly enhance security of supply reducing the chances of bilateral disputes affecting gas supply, and ensuring much needed investment in the Ukraine transmission infrastructure.
Thank you for your attention!