



## **MOSCOW INTERNATIONAL ENERGY FORUM** **«RUSSIAN FUEL AND ENERGY COMPLEX IN THE XXI CENTURY»**

Central Exhibition Hall «Manege», Moscow

119019, Moscow, PO Box 76

Tel/Fax (495) 664-24-18 www.mief-tek.com e-mail: info@mief-tek.com

### **«United Europe Outlined the Contours of its Energy Future»**

*Comments on the results of the EU Energy Summit held on February 4, 2011 in Brussels.*

#### **United Europe – Test of Unity**

On 4 February, the first European Energy Summit in the format of meeting by the EU state leaders was held in Brussels, against the background of an aggravating eurozone debt crisis. The sovereign debts of a number of the states amount to several hundred billion euros and now there is no clarity whether the European stabilization fund of EUR 750 bln. or credit arrangements will cope with this extremely grave eurozone problem. Today, it is quite difficult to evaluate the real scale of the consequences following sovereign debt restructuring, but anyway the solution of this problem will be certainly affected by a number of negative processes. Firstly, the problem states, such as Ireland, Greece, Spain and, probably, Portugal, will have to tighten their budget belts, while toughening the budgetary policy, that is normally based on increasing tax pressure and reducing community expenditures, is extremely unpopular among the taxpayers. Therefore, there is no guarantee that Europe will not be overflowed with a new wave of mass protests, like those that have occurred in Greece and France recently. Secondly, the high oil prices and, in whole, quite a hazy perspective on other commodities markets complicate the task of financial stabilization in the eurozone. Thirdly, debt restructuring may aggravate the situation in the European real economy crediting, which, in its turn, may change the direction of the hardly marked vector of the economic stabilization. Finally, the policy of «pulling» the European Union out of the debt crisis to the prejudice of the own sovereign development that is conducted by the German and the French governments (the leading eurozone states) has caused increasing public discontent.

It is obvious that the leaders of the principle European integration donor countries will need politic will, unity and consistency to prevent the shaken all-European ship from hitting new hidden reefs and to navigate it out of this debt storm with minimal damage.

#### **Energy Diversification at All Costs?**

Let me turn back to the energy industry itself. So, the result of the EU Energy Summit has not been unexpected. On the contrary, its decisions has been fully compliant with the strategic conception that was outlined as early as in 2006: uniting and liberalizing the European energy market, diversifying the export corridors of energy resources, prioritizing the alternative energy industry

development and boosting energy efficiency in all economic sectors sharply. The summit has confirmed the commitment to the previously defined strategic goals in the form of three «20»s.

Thus, the united Europe wants to have a united market, a united economic strategy and a coordinated energy policy as the principle tool for implementation of this strategy. It is all clear: everything corresponds to the main vector of the European integration defined by the Lisbon agreements. Probably, this strategic course is absolutely natural for the European Union deprived of its own energy resources deposits, especially with a view to long-term climatic and energy security. After all, this course is in total accordance with the global energy trend – progressive conversion to alternative and low-carbonic energy production.

In short, Europe is on the right way. So, what is the problem? The problem is that such ultimate and irrevocable EU stance will greatly influence development of the energy industries and the energy markets in dozens of countries, including those beyond EU. Especially tangible consequences should be expected in the countries traditionally supplying energy resources to EU. And while the states claiming to host some parts of the new export corridors, such as Turkey, Qatar, Nigeria, Azerbaijan, Turkmenistan, will gain profit, the consequences for Russia, Ukraine, Belarus will be rather negative. The fact that Russia is the largest supplier of primary energy to EU is an advantage that has turned to be a drawback too. Since the transit crisis, when a Russian-Ukrainian conflict deprived the European customers of gas, the necessity of reducing the energy dependence on Russia has been voiced more and more clearly in EU. And it is the very purpose of the new EU energy strategy. Even without addressing to the well-known facts, such as the notorious third energy package, but just trying to see the things behind the wording of the Brussels session final communiqué, we may state that today's interests of the Russian external energy policy will be considerably infringed in all domains. For instance, EU has assumed almost complete competence to adopt all key strategic decisions concerning energy. Moreover, since 2012, EU will control all agreements concluded on the national level with third states and companies from third states. In fact, Russia is being bereaved of the main tool for promotion of its energy interests, that is intergovernmental and intercorporate bilateral agreements. And even though EU does not take away EU member's right to conclude such agreements yet, the very requirement to announce them is the first step toward their limitation. Now we go further. What does «diversification of export» mean for Russia? It means that Russia will not only lose its export share but that it will have to cut prices - in particular, the gas prices. It means that when the number of the suppliers and of the export corridors grows, EU will have a real opportunity to hold a maneuver and to control the situation, in particular, to develop the spot market. And this is a clear encroachment on long-term contracts. That is why the diversification in the European manner is a geopolitical factor; and EU seems to be seriously determined to achieve the goal at all costs. We will take the gas market for example. EU wants to broaden the «southern export corridor», among other things, by building the Nabucco pipeline. It happens in spite of the serious resource problems of the project and that the question of Turkmen gas transportation

through the Caspian Sea is far from being solved. The legal status of the Caspian Sea is not defined yet and the Turkmen claim for approval of construction of the Transkaspiian gas pipeline by Turkmenistan and Azerbaijan in bilateral format is not supported by other negotiators. However, EU persists with most favored nation treatment of this project. Meanwhile, the South Stream project has never obtained the status of EU priority project.

Therefore, it may be stated that the new EU energy strategy, politically encouraged by the EU leaders in Brussels, has neither developed the Russian-European energy dialog nor accelerated the process of strategic partnership agreement signing. What does it imply? It implies that the «European geopolitical self» comes first for EU, and it prefers the Nabucco-related potential risks and the obviously higher price to pay, proceeding from the geopolitical considerations only, as it finds that dependence on Russia would cost even more. It implies, on the one hand, that EU does not actually have any other strategic alternative and, on the other hand, that EU feels too strong and confident to reckon with the Russian interests, or make concessions with Russia, or look for new compromises.

However, the new EU energy strategy contains, apart from other things, considerable risks for its developers. Again, it is premature to assess well-being of such different countries, as, for example, Germany and Poland, under the same European energy roof. The Poles have never acquired German support in promotion of the Polish CNG project yet. Why? It is because Germany will soon get plenty of gas through Northern Stream and it is not interested in too much gas in the neighboring Poland. Another question is who will venture to invest a hundred million euros in the alternative energy if the oil prices drop and the profitability of the traditional energy sector is high again. You see, the history repeats itself and, unless the global financial system and US monetary policy undergo critical changes, it is quite possible that in 2012 the new oil bubble will burst and the prices will drop to USD 50-60 a barrel. Next point. Will RWE, a German energetic giant, bear the uncertainty in terms of resource filling of Nabucco, which persists for several years? Will it still keep to the «corridor» of turn to the «stream»? Only time will answer these questions.

What remains to Russia? Firstly. It is absolutely clear that our stance in the relationships with the West needs considerable strengthening. Of course, someone else could be in this situation instead of us, but the state of things on the European market is like it is. It is understandable that within the coming decade the physical share of Russia in the EU export balance will not seriously decrease but its percent share will be steadily reducing. Probably, Russia could be more flexible in its relations with EU, still now it seems by no means ready to encroach on the sacred things like the integrity of Gazprom. Well, the competition on the European market is getting harder and Russia will have to turn to the East – to develop the domestic market and to try to force its way to the markets of China and of the Asia-Pacific Region. However, movement along these relatively new strategic directions is associated with considerable risks and uncertainties too. Firstly, the Chinese market is a part of the global market, so its competition level will increase too. Secondly, long-term Chinese market forecasting is complicated by fuzziness of the

future energy strategy of China. The degree, in which China will use its stocks, including the unconventional sources, will determine its commodities import dynamics. Thirdly, the Chinese market is, above all, a buyer market and, in China, one should not expect market profitability matching that in Europe.

The issue of the domestic gas market is not so definite either. The planned increase of the domestic gas prices may fail, as the production beyond the fuel and energy complex is in a deepest crisis. And investors are not too eager to work with Russia. The relative macroeconomic stability conceals a genuine knot of problems; the major problem there is lack of real structural changes and accompanying internal factors of economic growth, as well as the inability of the government to build a new economic model. It comes out that it is the Russian customer who will have to clear up the «energy mess» made in EU, with all ensuing consequences. Yet, as the phrase goes, every cloud has a silver lining, as our commodities export is both our advantage and our trouble. Probably, one day we will thank our European partners for their having made us finally pass from words to deeds, turn to President Medvedev's four «I»s (institutes, infrastructure, innovations, investments), start building a normal civilized market economy in which the private business, the economic freedom and the competition are key values.

**Principal Analyst of the Forum**

**Alexander Epishov**

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