The evolution of the energy relations between the EU and Russia through sectoral agreements or a new partnership agreement.

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It is a great pleasure to be here today. But it is also a challenge to address this theme at a time when several irritants are distracting us from the overall objective of promoting the integration of our common continent.

In the European Union relations with Russia there is currently a clear disconnect between the institutional and the trade aspects. On the one hand, continuing concerns keep being expressed about the lack of common values, securitization of the energy relations in terms of risks and threats and several bilateral problems between some EU Member States and Russia. On the other, trade is generally flourishing except for a few recent difficulties. Russia is the third trading partner of the EU and the EU is the first trading partner of Russia. Trade in goods has been growing at a healthy 4.5 percent annually between 2008 and 2012. Energy represents more than 80% of EU imports from Russia while finished products represent 98% of EU exports to Russia.

However, if the trade of raw materials for finished products might generate interdependence, it never has and never will by itself lead to integration. While the EU has, since the late 90ies, promoted the liberalization of the energy markets, exporting countries including Russia have been, on the contrary, moving towards the renationalization of energy resources. National oil and gas companies today own close to 95 % of world hydrocarbons reserves. So two models confronting each other.

The trade in natural gas, which had been underpinning the EU's good relations with Russia even during the height of the so-called "Cold War", has progressively transformed during the last decade into an element of distrust and polemic.

Before moving into the intricacies of the EU-Russia New Partnership Agreement or Sectoral Agreements, I would like to concentrate on some facts that might contribute to clarify and bring more objectivity into the debate.

Over the past couple of years, it has been the flavour of the day amongst some commentators not just to advocate a diversification of external energy supplies but also to advocate a decrease in the dependency on Russian energy, with an easy shortcut in the western media often conveniently confusing Russian gas with Russian energy and security of energy sources with security of transit.

What is the real situation on the ground?

Russian Energy Supplies

Firstly, between 1990 and 2012, the share of Russian coal in total EU coal imports has been multiplied by a factor of six (25 %), the share of Russian oil imports has doubled (30 %) - a welcome diversification -, and Russian enrichment services for uranium account for 42% of total EU use.

The only fuel where there has been no increase and, in fact, a significant decrease in market share in the EU has been Russian natural gas. The share of Russian gas as a percentage of total EU gas imports has gone down from 80% to 30% over the last decades. In volume, Russian gas exports into the EU have remained constant if not slightly decreasing over the past 20 years. In 2012, Russian gas represented less than 6% of total EU energy consumption.

What finally makes Russian natural gas a concern is not its volume or share of the total EU market, but the lack of potential alternative gas supplies in certain EU Member States and an unclear pricing policy which, to some commentators, does not always seem to reflect economic fundamentals.

Would there be a world market for natural gas and diversity in alternative supply possibilities, as well as a fully interconnected EU market, the share of Russian gas could well increase as has been the case for coal, oil and nuclear fuel. On a cost base – not to be confused with current prices -, Russian conventional gas is the most competitive source of natural gas potentially available in the EU. So a paradoxal conclusion: increased international natural gas competition might benefit Russian gas export volumes.

Energy Independence

Secondly, energy independence. Following the news coming from the US about their possible "energy independence", this concept has been starting to hit the streets in some of the EU Member States. And here is the very encouraging news: in physical terms our Eurasian continent – from Lisbon to Vladivostok - could be totally independent from energy imports by 2030. The only obstacle that remains in the way is one of the political will.

To finish on this point, Russia will remain the most important energy supplier of the EU and bearing in mind the uncertain geopolitical situation in other areas of the world with significant energy reserves, this should be reassuring news. Russia, and before it the Soviet Union, have been a reliable energy supplier, but the events of the last seven years have also clearly demonstrated the importance of ensuring the security and transparency of transit and, within the EU, the necessity of further interconnections, reversibility of the energy networks and additional trunk pipelines.

Interdependency

This brings me to a third remark: interdependency. Over recent years, interdependence between the EU and the Russian Federation for natural gas has been heavily politicized and presented on both sides almost as a negative phenomenon, that Russia and the EU have no other alternatives. I would venture to say that this interdependency is asymmetric and that the EU might be more dependent on Russia than Russia is dependent from the EU. Hence, energy might not be the most forceful negotiating instrument for the EU.

Why? If you look into Russian hydrocarbon export revenues you will discover, and for most of us it comes as a surprise, that more than 80% of those export revenues are generated by oil and not natural gas. Russian export revenues from oil for 2012 were about 285 billion US $ for natural gas it was only around 65 billion US $. So out of the total of 350 billion US $, the lion's share is oil and it is a fungible product: if Russia does not sell oil to the EU, it can and will sell it somewhere else. As for natural gas, exports into the EU represent less than 12% of Russian hydrocarbon export revenue.

The EU made Russian gas important, not Russia. May I add that until 1991 there was even an EU Directive forbidding the burning of natural gas in electricity power plants.

When the Energy Dialogue was started in 2000, the main subject was oil and improving the oil security of supply through diversification.

You should recall that we were just in the middle of an oil shock and natural gas never really came to the negotiation table as a security issue until 2006.

If Russia turned off the natural gas tap for any length of time-they have never deliberately done it against the EU – they would lose revenue. They probably wouldn't, for example, be able to continue to cross-subsidise the Russian consumer and would have to scale back on some ambitious projects. They would need to find new customers – difficult in the short run bearing in mind the regional nature of pipelines - at prices that might be nearer to coal prices but the damage would remain to some extent limited. But for the EU, it is unlikely that other gas suppliers could rapidly make good for the shortfall either through pipeline or LNG.

The fact that Russia imports only manufactured goods from the EU, goods that are also available somewhere else on the world market, weakens the bargaining position of the EU.

Having set the scene, let's turn now to the other part of the equation.

Partnership and Cooperation Agreement

The Partnership and Cooperation Agreement (PCA) was concluded in 1994 and entered into force in 1997 - after a long period for ratification by all EU Member States - for a ten year period. Article 106 foresees that this agreement is automatically extended each year –as is the case currently - unless either side informs the other at least six month before the expiry date.

Already back in 1999, the Russian Federation wanted the PCA updated and asked for the joint elaboration and conclusion of a new framework agreement on a Strategic Partnership and Cooperation in the 21 Century. This is because firstly the preamble and Article 1 of the PCA refer to Russia being an economy "in transition", which is no longer the case. Secondly, the Russian Federation wanted a partnership between equals, which is quite different from the provisions of Article 55 of the PCA which states that “Russia shall endeavor to ensure that its legislation shall be gradually made compatible with that of the Community”. If this formulation is appealing to countries seeking EU membership; for Russia there was and is still no such motivation to harmonize its legislation with that of the EU.

The most significant contrast between the respective positions of the partners is provided by the EU and Russia Strategy papers of June and October 1999. While the EU Common strategy paper insisted on “the foundations of shared values, the Common heritage of European civilization, a stable, open and pluralistic democracy and rule of law underpinning a prosperous market economy", the Russian Medium Term Strategy does not make any reference to common values but insists on the independence and sovereignty of Russia and the need to develop a strategic partnership with the EU. The Russian strategy also referred to the role model of the EU for integration prospects within the CIS, a curtain raiser for the currently developing Eurasian Union. Fifteen years later the respective positions remain broadly the same.

To go further in the direction of a strategic partnership, even if the full potential of the PCA was never exploited, the EU and Russia agreed at the St Petersburg Summit in 2003 to create, in the long run, four "common spaces”: a common economic space; a common space of freedom, security and justice; a common space of external security and a common space of research and education. But as was already the case for the PCA, the four spaces approach did not translate into a strategy designed to answer the question of the long term future of our common continent.

By 2005, progress had been coming to a standstill. The enlargement of the EU to the Central and Eastern European countries in May 2004 brought not only a diversity of opinions towards Russia but imported also the problems some of these countries had with Russia. The start of the negotiations for the new agreement in 2006 was first blocked by a Polish veto and then put in danger by Lithuania. The official start at the Summit of Khanty-Mansyisk in 2008 clarified the aim of the New Agreement.

New Agreement

The New Agreement should provide “a comprehensive framework for EU Russia relations….a strengthened legal basis and legally binding commitments covering all main areas of the relationship, as included in the four EU/Russia Common spaces and their road maps”. The diversity of areas raises the interesting topic of the legal basis of such an agreement. A Strategic Association Agreement under Article 217 TFEU similar to the proposed Ukrainian one and its asymmetric connotation seems politically unacceptable for Russia. An agreement based on Article 8 TEU referring to the "special relationship with neighbouring countries" could provide an answer but here again the fact that it should be founded on the values of the Union does not fit the Russian view. Article 212 TFEU which refers to economic, financial and technical cooperation or Article 207 TFEU if more limited to trade and investment could provide a possibility but here again the reference to "the principles and objectives of the Union's external action" defined by Article 21 TEU makes the respect of EU values a must. Finally a "comprehensive framework…covering all main areas…" requires, besides unanimity in the Council, consent of the European Parliament and ratification by each of the 28 Member States national parliaments.

Moreover, the Eurasian Union which should come into effect in 2015 and the related Customs Union - the member countries of which today are Kazakhstan, Belarus and the Russian Federation – is a new challenge for the negotiations of a New Agreement. One of the aims is to create a supranational structure that would deal with international partners as the EU "on an equal basis". Analysts still have mixed opinions whether such a Union could prepare the ground at a later stage for an economic space from Lisbon to Vladivostok as has been argued by the Russian President or a new competing space of integration with a primarily geopolitical purpose.

Russia did signal that, in the future, the negotiations on the New Agreement might aim at a regional agreement between the EU and the Eurasian Union. If the Eurasian Union becomes a reality by the end of 2015, and bearing in mind the current difficult climate and slow process of the EU-Russia bilateral negotiations, this question is far from being only theoretical. However, for the EU, such a prospect does not appear possible at least as long as the three members of the upcoming Eurasian Union are not also members of the WTO and until they would all have concluded bilateral partnership and cooperation agreements with the EU.

After twelve rounds of negotiations between the EU and the Russian Federation up to December 2010, a pause was decided. As of today, there still seems to be no clear agreement on the nature and purpose of the treaty. On the basis of the current state of affairs, it would appear that the views over the last three years have become more divergent than convergent. The Russian view seems to remain constant that the New Agreement should be a short (10 –20 pages) framework document establishing the major principles for cooperation incorporating the main provisions agreed upon for developing the four common spaces, with the detailed regulation being left to separate sectoral agreements to be negotiated at a later stage.

Russia has made it clear that, with respect to the trade part of the New Agreement, this should not go any further than their current commitments in the WTO. In other words, this begs the question as to whether a comprehensive agreement is needed at all. Russia currently refuses the idea of a bilateral WTO+ i.e. bilateral commitments going beyond these accepted at the multilateral level. As one Brussels think tank puts it, the EU seems to be using trade agreements to promote its views on how countries should be run. In the case of Russia, this would not fit its fundamental principle of a negotiation between two equal partners.

For the EU, the New Agreement should ”provide a more comprehensive framework for EU-Russia relations, reflecting the growth in cooperation since early 1990” and include substantive, legally binding commitments in all areas of the partnership, including political dialogue, freedom, security and justice, economic cooperation, research, education and culture, trade, investment and energy.

In the meantime, it has been decided in 2010 to set up a Partnership for Modernisation (P4M) with the aim reinforcing cooperation within the “four spaces”. As far as energy is concerned, the emphasis has been placed on «sustainable low carbon society and energy efficiency”. Projects are supposed to support the existing EU-Russia sectoral dialogues without the creation of new structures and overall, since 2010, a sum of €7 million has been allocated. But the concept of modernization is interpreted in some different ways by Russia and the EU. For Russia, modernization should be focused primarily on technology transfer, innovative industries, visa-free regime and state-led initiatives, while for the EU priority is given to an holistic approach strengthening the rule of law and civil society, fight against corruption, market liberalisation, cooperation in science and research and adequate joint financing.

So where do we stand on energy?

The Energy Charter Treaty

The seminal Treaty relating initially to energy cooperation and the CIS countries was the Energy Charter Treaty (ECT) of 1994. The ECT represents the first international regime in energy trade and transit, themes that are not addressed in a specific enough manner in the WTO. Developed at a time when Russia was in transition, the treaty deals with investment protection, trade, transit and dispute settlements and, according to producer countries, is to some extent too unbalanced in favour of energy consuming countries. From the Russian perspective, the ECT is viewed as a EU sponsored treaty.

In 2009, Russia withdrew from the Charter, although it remains active in the work of the Secretariat and participates in meetings. The two main points of contention were Article 7 and the principle of free transit whatever the ownership, the country of origin and the destination of the energy and Articles 8.4 and 10 referring to the Regional Economic Integration Organisation (REIO) Clause, where the EU requested to be defined as an economically integrated region so as to apply the stricter EU rules rather than the rules of the Energy Charter.

In parallel Russia tabled in 2009 - 2010 a proposal for an International Energy Convention, a legally binding document covering export, import and transit countries that would be less intrusive than the ECT. The main points of this proposal were demand security as the reverse side of the coin to security of supply, national sovereignty, state to state dispute settlement, asset swaps, fair allocation of risk through long term contracts and the application of the convention within REIO.

On November 24, 2010 a roadmap for the modernization of the ECT was adopted. The modernization should take into consideration, inter alia, high energy prices, the increasing importance of producer states, the importance of BRIC countries in energy consumption and the priorities given to renewables, energy efficiency and climate change. This could allow for a return of Russia to the negotiating table since the Russian proposal was also taken into consideration. Should these negotiations lead to a new treaty adopted also by Russia, it could be included as such in the bilateral EU-Russia New Agreement, with more specific questions being left for later on.

Energy Dialogue

In parallel to this multilateral Treaty and in the framework of the PCA, the EU and Russia decided in October 2000 to start an Energy Dialogue with the aim to establish a strategic energy partnership. It took over, at a bilateral level, objectives of the ECT with, however, a softer tone and a better balance between EU security of supply policies and Russian security of demand priorities.

As defined in the 4th progress report of this Energy Dialogue in 2003, “it should aim at the establishment of an institutionalized relationship between Russia and the EU in the field of energy, which would pave the way for the creation of a real Energy Community”. This project of an Energy Community between the EU and Russia that would have been legally binding, equitable and mutually beneficial was confirmed at the highest level by the European Commission and the Russian Federation at the end of 2003. But being probably too ambitious for a EU on the eve of enlargement, it was politically traded in from the EU side for non-binding ad hoc energy themes needed to provide additional substance to the four spaces bearing in mind the importance of energy in the bilateral relations.

This was the turning point that converted the energy dialogue from what could have eventually become an energy strategic partnership into essentially an efficient problem solving tool. However the term “strategic partnership” did create expectations that were not fulfilled as such since a “partnership” involves some exclusivity, equal rights and a constructive discussion about the relationship; and a “strategy” needs clearly defined common goals, timeframes and action plans and implies a common intention to reach these goals.

By 2005, a very different Energy Community had been created at the initiative of the EU, gathering together the south eastern European countries and recently adding Moldova and Ukraine. Today the leitmotiv behind this Energy Community Treaty is the import of the EU energy regulatory framework into non-EU neighbouring countries, including recently the Third Energy Package and its unbundling rules, albeit with longer timelines than required for the EU Member States. Needless to say, this evolution has been and remains an additional serious irritant for Russia in its bilateral energy relations with the EU.

Although the two interruptions of supply during the second half of the decade resulting from commercial disputes between Russia and Ukraine were never deliberately targeted by Russia against the EU, they resulted in pushing Russia and the EU further apart. They led directly to the EU calling for a reduction of the gas dependence from Russia, even though the share of Russian gas imports in total EU gas imports had already significantly decreased over the last decades and to Russia considering to embark upon a massive Ukraine by-pass pipeline project to, as they put it, reduce transit risk, the alternative being to address the practical challenges of ensuring stable and transparent gas transit. This will bring the capacity of Russia's export gas trunk pipelines towards Central and Western Europe to a level of above 350 bcm by 2030. This compares to the Russian proposal at the 2008 Paris EU-Russia Energy Permanent Partnership Council to increase Russian gas exports to the EU by 2030 to 220 bcm, which is nearly twice the 2012 level.

More recent developments have been a mixed bag: the EU and Russia Energy Early Warning Mechanism to overcome an emergency situation, mitigating its consequences and preventing such situations in the future, the opening by the European Commission of proceedings against Gazprom which may be hindering competition in Central and Eastern European gas markets, the EU-Russia Gas Advisory Council to evaluate long term trends, the organization and structure of gas markets and gas infrastructures, the Third Energy Package and the EU-Russia Roadmap for energy cooperation until 2050.

This latest agreement should give us some room for optimism over the longer run.

The strategic target for 2050 is a Pan-European Energy Space. The starting point is to define how one would like to see the relations between the EU, Russia and their common neighbours by 2050 and then to define the energy cooperation pathway to get there.

The independent experts who prepared the ground for the roadmap, to paraphrase Martin Luther King, had a dream.

By 2050, Russia and the EU should be strategic allies. Russia, its non-EU neighbours and the EU should have moved steadily towards a common market, supported by a further political rapprochement between the EU and Russia.

The non-legally binding 2050 Roadmap document formulates, for each energy sector, recommendations, defines a set of actions and establishes milestones between now and 2050. It could constitute a first step in the formulation of a true joint energy strategy to achieve, by 2050, a common energy space.

Ladies and Gentlemen,

This European continent is still looking for its identity. The EU and Russia are still trying to find their place in the world of tomorrow. And in this world size will matter. Whatever form the future agreement will take, there is a fundamental need to think strategically and over the longer term to create an integrated continent from Lisbon to Vladivostok.