

Doc. 11116
20 December 2006

Peril of using energy supply as an instrument of political pressure

Report
Political Affairs Committee
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Summary

The changing energy landscape is a cause for concern for all regions of the world, and in particular for most European countries. European energy demand in fossil fuel based energy, with oil and gas taking the greatest share, continues to grow and is expected to rise by some 60% by 2030. Taking into account the limited indigenous energy resources in most European countries, this expected growth in demand unavoidably means a substantial increase in dependency on oil and gas imports.

The Parliamentary Assembly believes that the time is ripe to raise the issue of the energy security in Europe in order to avert a possible energy crisis in Council of Europe member states, both for supplier and consumer countries. In particular, the risk of using energy supplies as an instrument for political pressure needs to be effectively eliminated.

The Assembly stresses the need for stable and sustainable economic relations in the energy sector between the main European energy exporter, the Russian Federation, and other European countries which depend on imports of Russian energy. This would be strategically beneficial for all concerned.

A. Draft resolution

1. The Parliamentary Assembly is aware that the changing energy landscape is a cause for concern for all regions of the world, and in particular for most European countries. European energy demand in fossil fuel based energy, with oil and gas taking the greatest share, continues to grow and is expected to rise by some 60% by 2030.
2. Taking into account the limited indigenous energy resources in most European countries, this expected growth in demand unavoidably means a substantial increase in dependency on oil and gas imports. Total energy import dependency amounts at present to nearly 50% in the European Union and is expected to reach 94% for oil and 84 % for gas by 2030.
3. Security in energy supplies - which includes stable and predictable energy supplies as well as transparency in energy prices - is a necessary precondition for the smooth and sustainable development of national and regional economies. In particular, the risk of using energy supplies as an instrument for political pressure needs to be effectively eliminated.
4. The Assembly regrets the unfortunate incident which took place in January 2006, when the gas supply from the Russian Federation to Ukraine was significantly reduced as a result of a unilateral decision threatening the stability of the economic situation in the latter country. The Assembly asserts that similar actions in the future could moreover result in energy difficulties in several Council of Europe member states.
5. The Assembly believes that the time is ripe to raise the issue of the future security of energy supply in Europe in order to avert a possible energy crisis in Council of Europe member states and foster the competitiveness of their economies in the global economic markets. In Europe, a stable and reliable energy system, based on mutual commitments in accordance with long-term agreements as well as on sound and transparent competitive rules would be beneficial for all Council of Europe member states, both for supplier and consumer countries.
6. The Council of Europe, which brings together both importing and exporting countries, can and should contribute to European energy security by promoting the idea of harmonising national energy policies with a view to the establishing a common energy strategy based on solidarity and fair and transparent economic standards and by encouraging its members to comply with the principles of market economy.
7. The Assembly supports the efforts of the European Union aimed at addressing the issue of stability of European energy markets, and it welcomes in particular the European Strategy for Sustainable, Competitive and Secure Energy being worked out by the Union in order to identify new challenges and responses regarding all aspects of energy policy.
8. Among the many factors which affect the security of energy supply, the diversification of energy imports is of crucial importance. The need for such diversification is demonstrated by the fact that, if the present situation persists, by 2020, the dependency on gas imports from the Russian Federation will be rather high. For historical reasons, Eastern and Central European countries have a much higher energy dependency on Russian energy export. For countries such as Georgia, Moldova, Ukraine and several new European Union member states this is a matter of major concern.
9. The question of diversification in the sources of energy supply cannot be addressed separately from the issue of systems for the distribution of energy. Increasing the choice of supply routes would enhance the security of energy transmission. The necessary investments in this area should be strongly encouraged by national legislation and policies which are both transparent and fair.
10. In this context, it is essential that the rules governing energy transit be based on the principles of market economy and should not be dictated by political considerations. The Assembly believes that the instrument which could ensure respect for these principles is the Energy Charter Protocol on Transit. Regrettably, negotiations on the draft text of the Energy Charter Protocol on Transit have not yet been successful.
11. Greater transparency in pricing policies and more efficient and competitive energy markets are also of crucial importance for European energy security. The Assembly notes that prices in the energy sector are currently not based on market economy principles. This problem should be addressed by European countries with a view to achieving prices which reflect the level of demand, the level of supply or seasonal flows.

12. The Assembly stresses the need for stable and sustainable economic relations in the energy sector between the main European energy exporter, the Russian Federation, and other European countries which depend on imports of Russian energy. This would be strategically beneficial for all concerned.

13. In particular, a substantial dialogue should be engaged with a view to establishing a fair and transparent energy system in Europe. The Assembly is convinced that this dialogue would be reinforced by the ratification by the Russian Federation of the Energy Charter Treaty and by the completion of the Energy Charter Protocol on Transit. The European Union-Russian partnership launched in 2000 to promote a new energy dialogue between the European Union and the Russian Federation should be enhanced.

14. Furthermore, the Assembly stresses the need for further development of new energy sources. Renewable energy is crucial for the future but is under-utilised notwithstanding its great potential in most European countries. Therefore the Assembly welcomes the European Union's resolve, in a White Paper on renewable energy sources, to increase the share of renewable energy in its total energy consumption to 12% by 2010. That said it would appear unlikely that renewable energy will play a major role in Europe's energy mix in the near future, on account of high initial investments costs and lack of confidence on the part of investors.

15. The Assembly believes that, in order to ensure that the principles of market economy are observed in the energy sector and that energy supplies are not used as an instrument of political pressure, it is necessary :

15.1. to set up a pan-European think-tank to engage a dialogue on energy security in Europe with a view to establishing a common strategy based on solidarity and respect for market economy principles and the interests of all parties concerned;

15.2. to formulate the main guiding principles of such a strategy, addressing such questions as diversification, transport, transparency of prices, modernisation and construction of infrastructure and use of renewable energy;

15.3. to organise a pan-European Conference, with the participation of both exporting and importing countries, devoted to security in the energy sector in Europe;

15.4. to ensure the signature of the Energy Charter Treaty by Council of Europe member states which have not yet signed it: Andorra, Monaco and Serbia;

15.5. to ensure the ratification of the Energy Charter Treaty by the Russian Federation and Norway;

15.6. to ensure the completion of the Energy Charter Protocol on Transit.

B. Draft recommendation

1. Referring to its Resolution (2006) on the Peril of using energy supply as an instrument of political pressure, the Parliamentary Assembly considers it essential for the Organisation to strengthen democracy and the rule of law as regards the security of energy supply.
2. Therefore, the Parliamentary Assembly recommends that the Committee of Ministers:
 - 2.1. launch a pan-European think-tank to engage a dialogue on energy security in Europe with a view to establishing a common strategy in this field based on solidarity and respect for market economy principles and the interests of all parties concerned;
 - 2.2. formulate guiding principles for such a strategy addressing such questions as diversification, transport, transparency of prices, modernisation and construction of infrastructure and use of renewable energy;
 - 2.3. invite all member states to participate in the establishment of a common pan-European strategy;
 - 2.4. organise a pan-European Conference on this subject;
 - 2.5. urge the Council of Europe member States:
 - 2.5.1. to honour their international commitments in the field of energy;
 - 2.5.2. to sign and ratify the Energy Charter Treaty if they have not yet done so;
 - 2.5.3. to show maximum goodwill towards the completion of the Energy Charter Protocol on Transit;
 - 2.5.4. to observe market economy principles in the energy sector;
 - 2.5.5. to allow third-party access to their pipeline network;
 - 2.5.6. to engage in a serious pan-European dialogue on security in the energy sector in Europe;
 - 2.5.7. to liberalise and integrate their own energy markets within the European energy market;
 - 2.6. study, within the framework of a special conference of the Council of Europe, the Eurasian Economic Community idea to create common energy space, with a view to a possible participation of all member States of the Council of Europe.

C. Explanatory memorandum by Mr Mihkelson, rapporteur

I. INTRODUCTION

1. The changing energy landscape is a cause for concern for most European countries. Global demand for energy is increasing and is expected to rise by some 60% by 2030. While import dependency of European countries is rising, oil and gas prices have doubled over the last two years.

2. Despite substantial indigenous energy resources, Western European countries need to increase their import to respond to growing energy demands. Gas demand, fuelled by economic and population growth requires gas imports. A significant portion of the current gas import capability to most Council of Europe member states comes from existing pipeline networks.

3. Trust and reliance on existing treaties and agreements is vital in this context and the Russian Federation has to agree to play by international rules if it is to maintain existing confidence in its willingness and capability to supply energy. Over the past 15 years there have been numerous occasions when Council of Europe member states have been subjected to energy supply cuts. In a recent analysis by Mr Robert L. Larsson, Swedish Defence Research Agency (FOI), it was found that there have been at least 35 occasions when supply was cut off or reduced during this period. Even if these overall figures must raise some concerns, some of these cut-offs may be explained by technical problems. Most affected countries have been Lithuania, Belarus, Georgia, Moldova, Ukraine and Georgia. These cut-offs inevitably have an adverse effect on confidence.

4. In view of the fact that Europe's future economic growth and stability is partly based on stable and predictable energy supplies, now is the crucial moment to initiate a discussion, which will hopefully result in more co-operation and solidarity amongst and between the member states of the Council of Europe in the field of energy.

5. A stable and reliable energy system, based on sound competition rules in Europe will benefit all, both those supplying the energy and those consuming it. This is most important if Europe has the ambition of being a competitive economic area in the future and being able to address the economic challenges stemming from the globalisation and the competition from growing economies in other parts of the world.

6. In January 2006, Mr Eörsi presented a request for a report on the "Peril of using energy supply as an instrument of political pressure" stating that the decision of Gazprom, as supported by the Russian state, could result in an energy crisis in several member countries of the Council of Europe.

7. I strongly believe that the Parliamentary Assembly could - and should - play a leading role by encouraging Council of Europe member states to agree on energy policies, at both political and economic levels and prompt members of the Council of Europe to implement coherent energy policies.

8. This memorandum aims to give a general overview of energy supplies and demand in Europe, to discuss the different areas of concern, especially the peril of using energy as a political tool, and to suggest a set of actions which I believe is required to ensure security of energy supply by the implementation of a common European strategy.

9. In the framework of the preparation of this report, the Committee organised a hearing with the participation of representatives of the International Energy Agency and International Association of Oil and Gas Producers, whose expertise on the subject has contributed to the preparation of the present report.¹ I have also carried out fact-finding visits to Poland (11-12 July 2006), Georgia (14 July 2006), OPEC (18 July 2006), Ukraine (23-25 October 2006) and Russian Federation (30 October-1 November and 20-21 November 2006)². I would like to express my gratitude to the national parliamentary delegations of these countries for their assistance in the preparation of these visits.

¹ See programme for the Hearing in Appendix 1

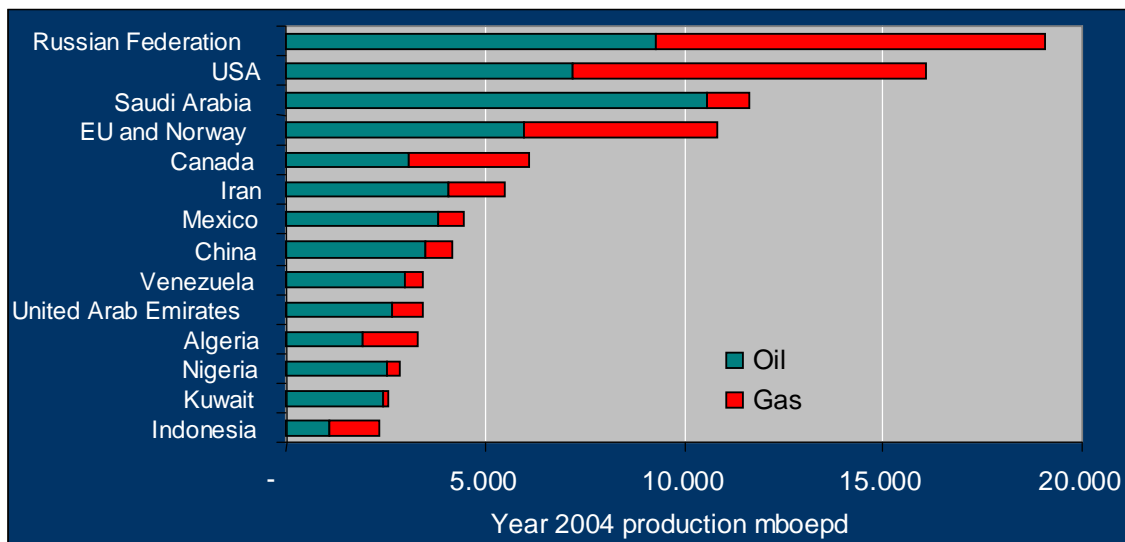
² See attached Programmes of the visits in Appendix 2

II. GENERAL OVERVIEW OF ENERGY SUPPLIES AND DEMAND IN EUROPE

Suppliers and consumers (statistics)³

10. Western European countries⁴ are in general consuming far more energy than they produce. In 2002, only Norway, United Kingdom and Denmark had a higher production of energy than their domestic consumption required. Eastern and Central European countries⁵ were almost totally dependent on energy imports from the Russian Federation and Azerbaijan, while most other European countries suffered from a deficit in energy during this period.

Suppliers of oil and gas



Source: British Petroleum Statistical review 2004

Oil suppliers

11. Whereas the combined oil production capacity from North America, Europe and China (amounting to 12% of global production, but only 6% of global proven reserves) has declined, Venezuela, Kazakhstan, Iran, Iraq, Kuwait, United Arab Emirates, Saudi-Arabia and Libya are in a position to increase their oil production.

12. The Russian Federation and Saudi-Arabia are currently the main producers of oil in the world. According to some experts (Mr Robert L. Larsson, Swedish Defence Research Agency and Mr Keith C. Smith, Senior Associate at Center for Strategic and International Studies), the production of the Russian Federation has already peaked, bearing in mind that there are some unexplored areas and there has been a decrease in the exploration for oil.

13. The oil suppliers to European Union (EU) countries are reflected as follows:

- 27% from the Russian Federation
- 19% from the Middle East
- 16% from Norway
- 12% from North Africa.

Gas suppliers

³ Regarding the statistical data, they come from the International Energy Agency and the International Association of Oil and Gas Producers, from which representatives presented their expertise on energy supplies and demand in Europe.

⁴ For the purpose of this Memorandum I have decided to apply this geographical distinction which corresponds to some differences in the field of energy. By Western European countries, I mean the following countries: Andorre, Austria, Belgium, Denmark, France, Finland, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, Monaco, The Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and United Kingdom,.

⁵ with the exception of the Russian Federation and Azerbaijan.

14. Gas energy supply in EU countries is currently reflected as follows: 46% is covered by the domestic production of the United Kingdom, the Netherlands, Germany, Italy and Denmark; 25% is imported from the Russian Federation, 15% from Norway; 14% from North Africa, Nigeria and the Middle East.
15. Importation as Liquefied Natural Gas (LNG) represents 8% from Africa and Middle East.
16. While the gas production of European countries has been stable over the last 10 years, production in the United Kingdom, after a long period of growth has begun to decline in the last 2 to 3 years, at the same time as the Norwegian production has shown a strong increase.
17. The Russian Federation currently accounts for more than 45% of total gas imports into the EU, equalling approximately 25% of total gas consumption.
18. Natural gas supply had the highest growth rate of all energy sources both in absolute terms (increased by 50% between 1990 and 2002), and in its relative share of the overall energy mix (from 17% to 23% during the same period).

Consumers

19. World energy consumption has almost doubled since 1970 and continues to rise in all regions of the world. It is expected that total world energy consumption in 2030 will be almost 60% higher than it was in 2002. The largest growth is expected in fossil fuel based energy, with oil and gas taking the greater share of around one third each of the expected increase. For example, the International Energy Agency (IEA) projects that energy consumption will double in China between 2002 and 2030. 30% of this growth is expected to come from oil and 10% from natural gas. In India, energy demand might rise by 90% up to 2030, with a 30% increase in oil demands and 14% in natural gas.
20. The Organisation for Economic Co-operation and Development (OECD)⁶ countries show a less spectacular increase in relative terms: IEA projects that energy demands will increase by 30% by 2030.
21. Regarding the EU member states' consumption of oil today represents 37% of overall consumption, followed by natural gas, which amounts to 24% of the EU's total energy consumption.
22. In Western Europe, consumption has grown annually on average by 1.1% between 1992 and 2002. In Eastern and Central Europe that figure is 2.3%.
23. Currently, the largest consumers of natural gas in Europe are the industrial and residential sectors.
24. It is estimated that over 60% of EU gas imports will come from the Russian Federation in 2030, resulting in an overall energy dependency close to 80%.

Energy transport

25. This expected increase in gas demand is inconceivable without modern distribution systems. Modern pipeline technology permits gas to be transmitted safely and cost-effectively over great distances. Current gas pipeline infrastructure connects Western European countries to the gas resources in the Russian Federation and to the reserve in North Africa. The pipeline grid is continuously growing and further interconnections increase flexibility in terms of diversification of supplies.
26. Increasing the choice of supply routes, especially new pipelines via Turkey from the Caspian Basin (Nabucco project), new lines of the Blue Stream (scheduled for 2010/2015), delivering gas to Southern Europe, the Baltic pipeline (scheduled for 2010) and the Norway-United Kingdom pipeline (should open in 2006/2007) could enhance the security in gas transmission and could promote further market development.
27. One essential aspect is, however, that the rules governing energy transit must be based on a combination of principles, security of deliveries and transparency of access to infrastructure. There have been some concerns expressed about the Baltic gas pipeline as this pipeline will take Russian natural gas

⁶ The thirty members of OECD are the followings: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

straight to Germany, bypassing all other countries. For example, Poland considers the construction of this pipeline as a political strategy rather than an economic concern.

28. The instrument that could create this security is the Energy Charter Protocol on Transit. At the current time, the text of the Protocol on Transit has not yet been agreed upon. The achievement of the agreement, satisfactory to all participants, would be an important step in the secure and safe international transport of energy in the future and would decrease the risk of transit countries misusing their control of the pipeline infrastructure.

29. Although the vast majority of gas supplies will continue to reach Europe by pipeline, the transport of LNG will become increasingly important, especially in countries such as Italy, Greece, Spain, Poland, Cyprus, Belgium, Portugal and France, where LNG terminals must be expanded. The growth in the transport of LNG is a result of the fact that the cost of LNG has decreased at the same time as an increase in its capacity. Currently, European countries share of the global LNG market amounts to 22%.

30. As Europe's energy demand increases, so does the need for underground storage of gas. Today European countries have a gas storage capacity of almost 60 billion cubic meters. Europe is also seen as the world's leader in storage technology. Spain, Portugal, France, Italy, Greece and the Baltic countries⁷ are involved in increasing underground storage capacity. At the same time, storage should be firmly controlled by the state.

31. The storage of gas is linked to seasonal changes. Gas is stored during summer months when demand is low and when the demand increases, as it gets colder, gas is taken from the storage facilities. New investments in LNG terminals and underground storage may thus play a major role in the security of supply by gas network in the future.

32. The transportation and distribution of oil is made by ship, barge, tankers, rail and pipeline. Contrary to gas, the distribution of oil is less concerned by energy supply security. The oil price is very much influenced by the high cost associated with its transportation.

Diversification and development of new energy sources

33. The development of renewable energy sources is in my view, a necessity for the future, even if they are under-utilised today despite great potential in most European countries.

34. In 1997, the EU drew up a White Paper on renewable energy sources aimed at increasing energy from renewable resources of its total energy consumption to 12% by 2010, requiring an estimated total investment of 260 € billion per year until 2010. In parallel to this White Paper, the European Commission will bring forward a Renewable Energy Road Map aimed at assessing renewable energy sources against the other options available.

35. Despite all the endorsement from the political level in Europe, it is, however, not likely that renewable energy will play a significant role in Europe's energy mix in the near future. This is due to higher initial investment costs for renewable energy and the lack of confidence on the part of investors.

36. Combined, these conditions stress the need for diversification of the energy resources. The diversification should not only promote the use of alternative fuels but also promote different choices of country of origin and transit through the establishment of new LNG projects.

37. While I strongly believe that it is necessary to pursue the development of renewable energy sources in the future as they could play a major role in the security of energy supply, these sources are currently not sufficiently exploited in most of Europe.

III. AREAS OF CONCERN

Oil and gas dependency

38. Energy dependency continues to be a source of concern, especially in the light of the increased cost for Europe's industrial and private consumers. The increased cost for the consumers in the end will result in Europe's competitiveness being affected in a negative way.

⁷ Estonia, Latvia, Lithuania

39. Most European countries depend on external sources for their energy consumption, the strongest dependency being on oil, followed by gas. They depend on oil supplies from Norway, the Russian Federation and OPEC countries, as well as on gas supplies from Norway, the Russian Federation and Algeria.

40. Total energy import dependency for Western European countries currently amounts to close to 50% and is higher for oil than for gas. Importation of oil could reach 94% in 2030 and importation of gas 84% instead of 50% at present.

41. For historical reasons, Eastern and Central European countries have even greater energy dependencies, especially on Russian energy export. For countries such as Ukraine, Georgia, Moldova and many new EU member states this situation is very problematic.

42. In my view, this imbalance must be addressed in order to minimise the risk of potential political instabilities and economic decline.

Increasing gas demand

43. As previously stated, European gas consumption is expected to increase considerably over the next few years. It is predicted that gas will become the fastest growing source of energy. Western European countries' share of gas in the overall energy consumption is projected to increase from 21% in 2001 to 27% in 2020.

44. The question is whether there will be enough gas supply to satisfy this increased demand? The capacity and sustainability of gas production levels will determine whether increasing global energy demand will be met. Energy experts have calculated that there will be enough gas supplies to satisfy this increased demand, even if Western European production decreases. Some industry observers estimate that, by 2020, European countries will depend on Russian imports for up to 70% of their total gas consumption. This is why it is also important to maximise the utilisation of indigenous energy sources.

Lack of diversity of supply

45. To face the increased demand for gas, the energy supply should respond to the need for more diversification by increasing investments in infrastructure in suppliers' countries. The situation is, according to international experts, extremely severe in the Russian Federation, for example. To refurbish its existing pipelines and build new ones, the Russian Federation needs significant investments that neither the Russian financial system nor Gazprom can deliver.

46. Without investments from outside the Russian Federation there is an overwhelming risk that the low quality of current infrastructure will result in involuntary and unplanned energy cut-offs in Europe, which will result in negative consequences for Europe's economic stability and potential to grow. This situation greatly enhances the risk of the Russian Federation not being able to honour its supply contracts to customers. And the situation is not likely to change unless there is a change of attitude on how the market is operated, including liberalising both the EU's and the Russian Federation's energy markets and increasing the investments that could come from Western European countries.

47. According to EU regulations, all companies interested in supplying gas should have free access to existing and future pipelines, even if they are owned by other companies. This is why Council of Europe member states should encourage the Russian Federation to ratify the Energy Charter Treaty (ECT) and ensure the successful completion, in co-operation with the EU, of the Protocol on Transit, so that the Russian Federation would allow open access to its pipeline network to third parties.

48. International observers, such as the International Energy Agency, estimate the current gas deficit from the Russian Federation is likely to grow to above 126 billion cubic meters by 2010, mainly because of the low quality of current infrastructure combined with a Soviet style approach of running the Russian gas market.

49. In reality the ambition of all Council of Europe member states ideally would be to create a single European energy market encompassing all Council of Europe member states, and ensure that it is implemented properly.

Peril of using energy as a political tool

50. The gas price dispute that erupted between the Russia Federation and Ukraine in January 2006 had a sobering effect on all European countries. When the gas supply to Ukraine was cut off, the Parliamentary Assembly voiced concerns over this unilateral decision to use energy supply as an instrument of political pressure. Blackmail is not an acceptable tool to use in a price negotiation between economic partners, which is why it is of utmost importance that Europe's future energy market is guided by sound economic principles and competition rules.

51. At the same time, the Parliamentary Assembly expressed its concerns over the fact that Europe's gas supply is being transported in one single pipeline. I.e. the same pipeline which was temporarily shut down in the dispute referred to above.

52. The above event illustrates more than before Europe's dependency on Russian gas. An angle less discussed is the Russian Federation's dependency on European markets.

53. This dependency was debated in October 2006 by the Parliamentary Assembly, which adopted Resolution 1523 (2006) on "**Europe's interest in the continued economic development of Russia**". The Resolution refers to how energy resources are at the heart of the Russian Federation's economy and its trade relationship with other European countries. It also stresses the need for complementary interests in the energy sector and the legitimate expectations on both sides and confirmed the need for Russian companies to expand foreign investment and technologies to develop new oil and gas fields in order to ensure reliable energy supply in Europe. Finally, it supported the need to maximise efforts to reach a compromise leading to an agreement on the Russian Federation's ratification of the ECT and related Protocol on Transit and recalled that "no other country in Europe stands to benefit as much as the Russian Federation from efforts to enhance energy efficiency".

54. The current imbalance in trade relationships is well illustrated in the case of Georgia. The country is trying to diversify its gas supplies, in order to avoid dependency on one energy source, from Azerbaijan through the Baku-Tbilisi-Erzurum transit pipeline and small volumes from Iranian gas. However, this initiative has been met with commercial coercion from its current supplier. The current political deadlock between Georgia and the Russian Federation can partly also be attributed Georgia's intent to diversify its energy supplies.

55. Which lesson must European countries draw from current developments? From my point of view, it is an urgent priority to co-ordinate Europe's energy policy, diversify its gas supply, invest in its infrastructure, increase interconnections substantially and increase its storage capacity.

Security of energy supply

56. Many studies on the future energy situation stress an increase in global energy needs due to population and economic growth, especially in the rapidly developing countries of Asia. This implies that most governments are concerned about the future security of energy supplies.

57. I believe that the establishment of a common strategy to address the security of energy supply will not be easy. Indeed, the energy landscape diverges from the preoccupation of the European Commission, which is in the process of completing liberalisation, unbundling large energy companies and breaking up long-term contracts with the Russian Federation, which is consolidating enormous power in the hands of a company with close links to the state. This situation is well illustrated by the Russian decree on "Energy Strategy of Russia to the year 2020", which explains that the Russian Federation is interested in securing supplies of oil and gas for its political interests in Europe, its neighbouring countries as well as in the Asian Pacific Region. However, it is underlined that this strategy is limited to one single company, e.g. the state owned company Gazprom.

58. At both economic and political levels, the security of natural gas supply in Europe as well as relations with gas producing countries are of increasing importance. In this context, an efficient energy market, based on the principle of a sound market economy, should be established, including a long-term geopolitical and strategic context under which political and economic drivers coexist.

59. Furthermore, European countries should be encouraged strongly to enhance the diversity of supply which would be a major step in achieving the security of energy supply.

Lack of transparency of prices

60. The lack of transparency of prices in the energy sector is a typical example of the fact that the energy market is currently not based on market economy principles. It results in a situation where many producers are linked to prices which do not reflect the level of demand, the supply levels or seasonal flows. The gap in gas prices between different countries varies by more than 300€/1000 cubic meters.

61. According to Gazprom, obtaining market prices seems to be a key objective. However, the price of Russian gas does not seem to reflect this objective regarding Georgia. Indeed, the price has risen from 45\$ per 1000 cubic meters in 2001, to 60\$ in 2004, 110\$ in 2006 and 230\$ in 2007. In reality however, it is impossible to discuss market prices of a market operated by a de-facto monopoly.

62. I believe Europe needs to be aware of the risk to its economy posed by high and fluctuating oil and gas prices and to achieve a greater transparency of prices that may attract foreign capital.

Lack of transparency of companies

63. In the Russian Federation, the gas sector is state-run, and operated by Gazprom, which, together with its subsidiaries, controls almost 60% of Russian gas reserves and produces about 85% of Russian gas⁸. Gazprom is also the largest company in the world. In this context, to obtain access to the pipeline transport, small independent production companies must co-operate with Gazprom. The political level in the Russian Federation is thus controlling the domestic gas sector as well as all its gas exports. Moreover, the Russian Energy Strategy approved in August 2003 projects that non-Gazprom production will account for merely 20% of total Russian production in 2020. It is clear that this situation does not lead to a competitive European market, where only larger companies can assume the exponentially higher risks of operating in areas that are politically and economically less secure. The European Commission has, at the same time, repeatedly expressed its concern over the lack of transparency in the EU gas market.

Lack of stability of energy markets

64. The global energy system could not function efficiently without free, competitive and open markets, even if many European energy markets remain largely national and are dominated by a few companies. Furthermore, to achieve more stability of energy markets, the market must be transparent and predictable.

65. Many efforts at European and international levels tackle the issue of the lack of stability of energy markets. In 1999 the EU started an internal and liberalised energy market which is expected to be completed by 2007. The Directives foresee that, in 2007, all customers will have a choice of gas or electricity supplier.

66. Moreover, at its last meeting in July 2006, leaders of the G8, presided by the Russian Federation, expressed their support for an open and transparent energy market. A well-functioning gas market is essential to attract global suppliers.

IV. EUROPEAN ENERGY POLICIES

Differences in interests between Western countries and Eastern and Central European countries

67. In order to secure a transparent and well-functioning market in the future, it is essential that European countries co-operate with the Russian Federation and persuade it to make Russia's energy policies more transparent and competitive and to diversify the gas supply and the distribution of transport. This task imposes particular responsibility on Eastern and Central European countries which are in a position to use more economic and political leverage on the Russian Federation.

68. The energy security of Eastern and Central European countries should be improved by increasing domestic energy storage, boosting indigenous supplies of gas and oil and by the creation of a transparent environment for foreign investors.

69. The Russian Federation has mainly targeted Estonia, Latvia, Lithuania, Ukraine, Belarus, Moldova and Georgia, e.g. former parts of the Soviet Union, with supply interruptions. Obviously, Western European countries have been affected by these interruptions, one example being Gazprom's attempts to monopolise all gas supplies from Turkmenistan, Kazakhstan and Uzbekistan.

⁸ Sources: Russia Profile.

70. After having made my own research and having consulted experts I have drawn the conclusion that there is a significant risk that the Russian Federation might interrupt energy supply to Eastern and Central European countries. However, according to several experts, it is very difficult to estimate the possible long-term risks of these interruptions.

Lack of solidarity and common strategy

71. Whilst the Russian Federation has consolidated enormous power in the hands of Gazprom and consequently the state, European policy has moved in the opposite direction towards a liberalised energy market.

72. I stress the need for Western European countries to co-operate in achieving a common strategy to encourage Russia's energy policy in becoming more transparent, competitive and reciprocal, by adopting business practices based on what is commonly accepted in the energy market. Structural and regulatory reform is also needed to ensure the efficiency of a common strategy.

73. The way forward, in my view, is to put in place a common strategy at European level that aims at ending bilateral deals based on purely nationalistic interests. This is especially important in the perspective of long-term contracts.

Co-operation within the EU

74. Different projects for co-operation within the EU are set up to challenge the fall of EU gas production and the increase of imports. Obviously, the Russian Federation will continue to play its major role in co-operation with the EU in this field.

75. Indeed, a Russian-EU partnership was launched in 2000 to promote a new energy dialogue; however, this dialogue is only limited to a few issues, since the EU does not represent all European countries and since many EU countries have bilateral policies in their engagements with the Russian Federation.

76. The EU, at its last Summit in October 2006, stressed the need for a "fair trade-off on energy", by offering security in EU contracts and expecting the same from the Russian Federation with access to its market. However, concerning the Shtokman project in the Barents Sea, the Russian Federation decided that Gazprom would be the sole developer of these vast gas deposits without direct ownership of foreign partners.

77. The EU has already started to develop energy agreements with other partners: The first one in December 2005 with Ukraine, providing a comprehensive framework for co-operation in gas markets and for enhancing the security of energy supplies. In November 2006, a Memorandum of understanding was signed establishing an energy partnership between the EU and Azerbaijan aimed at a greater integration of Azerbaijan into the European energy market, strengthening EU energy supply security through supplies from the Caspian Basin and transit systems.

78. By developing alternative energy supplies, the EU would also support Georgia, Bulgaria and Moldova in increasing their energy security.

Energy Charter Treaty and Transit Protocol

79. In December 1991, the European Energy Charter was signed in The Hague. This document was a declaration of political intent to promote co-operation between states within the energy sector.

80. The European Charter Treaty (ECT), based on the European Energy Charter, is a multilateral treaty dealing specifically with inter-governmental co-operation within the energy sector. To date, 51 nations have signed the ECT but only 46 of them have also ratified it. Among Council of Europe member states, Andorra, Monaco and Serbia have not signed the ECT.

81. The Russian Federation signed the ECT in December 1994 but has not yet ratified it, as is the case for Norway. However, the ECT should still be seen as binding for the Russian Federation, as it never stated that it would not apply the treaty when signing it. Should it have done so, which is what countries like Australia, Iceland and Norway did, it would not be binding according to article 45.1 of the ECT. As stated above, it is however of the greatest importance that the Russian Federation ratifies the ECT and ensures the successful completion, in co-operation with the EU, of the Protocol on Transit.

82. On 20 October 2006, at the European Union Summit in Finland, the Russian President Mr Vladimir Putin, indicated that he was not against the idea of incorporating the principles of the ECT into a new “strategic partnership agreement” with the EU but has refused as yet to ratify the ECT, arguing it would be forced it to open its pipeline network to third parties.

83. I encourage the member states of the Council of Europe to call for the Russian Federation to honour the ECT and to complete the Protocol on Transit.

84. Moreover, the implementation by the Russian Federation of the ECT and the completion of the Protocol on Transit would convince Europe that it has the intention of becoming a reliable supplier, which would result in greater competition within the energy transportation sector.

Multilateral international organisations

85. Political dialogues on energy issues among major energy consumers are reflected through multilateral international organisations like for example the G8 and North Atlantic Treaty Organisation (NATO).

86. At it's meeting in St Petersburg on 16 July 2006, the G8 adopted a joint statement on global energy, which recognised the shared interest of energy producing and consuming countries and which was committed to an open, transparent and competitive energy market as a key to global energy security.

87. The Economics and Security Committee of the NATO Parliamentary Assembly presented, on 17 November 2006, a resolution on improving global energy security. In this text, the NATO Parliamentary Assembly “urges the governments and parliaments of member and partner countries of the North Atlantic Alliance” to initiate and promote an energy security dialogue within and between its members and the EU, to diversify the sources of energy and to engage a dialogue on energy security with the Russian Federation.

V. PROSPECTS FOR A COMMON EUROPEAN STRATEGY

Need for a common European strategy

88. The development and implementation of a common European strategy among Council of Europe member states is essential if we are to avoid having to deal with emergency external supply difficulties in the field of energy in the future.

European Union strategy for sustainable, competitive and secure energy

89. On 8 March 2006, the European Commission published a Green Paper on developing a common, coherent European Energy Policy aimed at helping the EU lay the foundations for secure, competitive and sustainable energy.

90. This is a consultation document designed to stimulate ideas on what should be done to deal with practical challenges and problems. On the basis of the response to this Green Paper, the European Commission would like to develop more concrete ideas on a number of energy issues.

91. The Green Paper underlines the needs for sustainable, competitive and secure energy by identifying six key areas where action is necessary to address the challenges faced by the EU:

- Competitiveness and the internal energy market;
- Diversification of the energy mix;
- Solidarity;
- Sustainable development;
- Innovation and technology;
- External policy.

92. It is important that this approach does not stop in the EU but that each Council of Europe member state be encouraged to take this approach into account.

Energy Community South East Europe Treaty

93. The Energy Community South East Europe Treaty (ECSEE), signed in Athens on 25 October 2005, sets out to establish a single regulatory framework for trading energy across South-East Europe and covers the sectors of electricity, natural gas and petroleum products.

94. The ECSEE treaty was built on the South-East Europe Regional Energy Market for electricity and natural gas within the framework of the Stability Pact for South Eastern Europe through the Athens Memorandum of Understanding.

VI. CONCLUSIONS AND RECOMMENDATIONS

95. The Russian Federation can regain the trust and confidence of its European partners concerning its ability to supply gas to Europe. It can once again be seen as a reliable and secure supplier of energy in the coming years. But it is up to the Russian Federation to demonstrate that it wants to regain that trust and confidence. It needs to abide by its existing international obligations and respect international rules.

96. The aim is to achieve a competitive gas sector across Europe, providing better pipeline access to independent gas producers and oil companies, and by raising investment in LNG project.

97. I therefore urge the Russian Federation, as a first step, to act in accordance with the ECT, which it signed, and engage in a rapid ratification of the treaty itself. The ECT is currently the only international legal act that involves both Europe and the Russian Federation and should be the basis of further political discussions about the construction of a true internal market valid for all member countries of the Council of Europe.

98. I also urge the Council of Europe member states to press the Russian Federation to open and liberalise its energy market and integrate it with European energy markets

99. In order to make this a reality, Council of Europe member states should start by approaching the issue of security of energy supply on the basis of a common and integrated dialogue together with the Russian Federation.

**APPENDIX I – PROGRAMME OF THE HEARING ON SECURITY OF ENERGY SUPPLY IN EUROPE
Strasbourg – 3 October 2006**

8.30 am Opening by Mr Abdülkadir Ates, Chairman of the Political Affairs Committee

Introduction by Mr Marko Mihkelson, (Estonia, EPP/CD), Rapporteur on Peril of using energy supply as an instrument of political pressure

- Speeches by:

I. International Energy Agency:

Mr Ian CRONSHAW, Head, Energy diversification division
Presentation given a general overview on the energy supply and policies in Europe

II. Association of Oil and Gas Producers:

Ms Beate RAABE, Director EU Affairs
Presentation given a position on oil and gas producers

III. European Commission:

DG Tren: to be confirmed
Presentation given the EU position on security of energy supply in the EU

- General discussion - Exchange of views with participation of:

- Mr Leonid GRIGORIEV, President of the Institute of the Energy and Finances, Russian Federation

- Dr Alan RILEY, Reader in Law at City University London and Senior Research Fellow at Centre of European Policy Studies (CEPS), Brussels

- Mr Anatoly YANOVSKY, Director of Department, Ministry of Industry and Energy, Russian Federation

- Mr Valeriy YAZEV - President of the Committee of power engineering, transport and communications of the State Duma

9.45 am Concluding remarks by Mr Marko Mihkelson, Rapporteur

Closing by Mr Abdülkadir Ates, Chairman

APPENDIX II – Programmes of visits

**Visit by Mr Mihkelson, Rapporteur on the peril of using energy supply
as an instrument of political pressure
Warsaw (Poland) - 11-12 July 2006**

Monday, 10 July 2006

3.20 pm Arrival at the Okecie Airport, accommodation to the Hotel Sheraton Warsaw

Tuesday 11 July 2006

9.15 am Departure from the Hotel

9.30 am Meeting at the Ministry for Foreign Affairs, Mr Rafal Wisniewski, Deputy Minister

1.30 pm Lunch with the members of SEJM

3.30 pm Meeting at the Polskie Sieci Energoelektroenergetyczne (Polish Energy Network)

5 pm Meeting at the Office of the President with Mr Andrzej Krawczyk, Under-Secretary of State

Wednesday, 12 July 2006

8.45 am Departure from the hotel

9 am Meeting at the Ministry of Economy with Mr Piotr Naimski, Deputy Minister and with participation of representatives of PGNiG et ARE

10.30 am Meeting at the Office of the Prime Minister with the Secretary of State Mr Leszek Jesien

11.45 am Meeting with a representative of a Group on Energy- within the Polish Parliament

12.45 pm Lunch with senators

2 pm Meeting with the parliamentary Committee on Economy, Chairman Mr. Maks Kraczkowski

17.30 pm Departure for the airport

19.35 pm Departure for Vienna

**Visit of M. Mihkelson, Rapporteur on the peril of using energy supply
as an instrument of political pressure**

Tbilisi (Georgia) - 13-15 July 2006

Thursday 13 July 2006

Arrival at Tbilisi airport

Accommodation at the hotel: Marriot Courtyard

Friday 14 July 2006

Breakfast at the Hotel

- 11.00 am Meeting with The Chairman of the Parliamentary Committee on Sector Economy and Economic Policy, Mr. Niko LEKISHVILI
- 11.45 am Depart for the Ministry of Economy
- 12.00 noon Meeting with the Minister of Economy, Mr. Irakli CHOGOVADZE
- 12.45 pm Depart for the Ministry of Foreign Affairs
- 1.00 pm Meeting with the Deputy Minister of Foreign Affairs, Mr. Nikoloz NATHBILADZE
- 1.45 pm Depart for the Ministry of Energy
- 2.00 pm Meeting with the Minister of Energy Mr. Nika GILAURO
- 2.45 pm Depart for the Georgian Gas International Corporation.
- 3.00 pm Meeting with the President of the Georgian Gas International Corporation, Mr. David INGOROKVA
- 3.45 pm Depart for the JSC –National Company “Georgian Oil”
- 4.00 pm Meeting with the General Director of the JSC National Company “Georgian Oil”, Mr. Vano NAKAIDZE
- 4.45 pm Depart for the Georgian National Energy Regulatory Commission
- 5.00 pm Meeting with the Chairman of the Georgian National Energy Regulatory Commission, Mr. George TAVADZE
- 20.00 Dinner hosted by the Chairman of the Sector Economy and Economic Politic Committee

Saturday 15 July 2006

- 04.45 Departure for Vienna

**Visit by Mr Mihkelson, Rapporteur on the peril of using energy supply
as an instrument of political pressure**

Kiev (Ukraine) - 23-25 October 2006

Monday 23 October 2006

15.45 pm Arrival in Kiev

Tuesday 24 October 2006

9.00 am Meeting with Mr. Kulyk, Deputy Head of Foreign Policy Directorate of the Secretariat of the President of Ukraine

11.00 am Meeting with Mrs O. Makarovska, Deputy Chairperson of the National Committee on Nuclear Regulations

13.30 am Meeting with Mr. S. Korsunsky, Director of Directorate General for Economic Cooperation, Ministry of Foreign Affairs of Ukraine

15.30 am Meeting with Mr. Yuli Joffe, Deputy Minister of the Ministry of Energy of Ukraine

17.00 am Meeting with Mr. Martynenko, Chairman of the Committee on Energy, nuclear policy and nuclear security of the Verkhovna Rada

Wednesday 25 October 2006

10.35 am Meeting with Mr. O. Rogozin, Chairman of National Committee on Electric Power and Energy

16.30 pm Departure for the airport

**Visit by Mr Mihkelson, Rapporteur on the peril of using energy supply
as an instrument of political pressure**

Moscow (Russian Federation) - 30 October-1 November 2006

Monday 30 October 2006

9.35 am Arrival at Sheremetievo airport, transport to Moscow

Tuesday 31 October 2006

8.50 am Meeting with Mr. A. Denissov, First Deputy Minister, Ministry of Foreign Affairs of Russian Federation

10.00 am Meeting with Mr. L. Grigoriev, President of the Fund "Institute of Energy and Finances"

14.00 pm Meeting at United Electricity System with Mr. L. Gozman, Member of the Board

16.00 pm Meeting with Mr. A. Yanovsky, Director of Department, Ministry of Industry and Energy of Russian Federation

Wednesday 1 November 2006

12.00 noon Meeting with Mr. V. Yazev, Chairman of State Duma, Committee on Energy, Transport and Communications

16.30 pm Departure for the airport

**Visit by Mr Mihkelson, Rapporteur on the peril of using energy supply
as an instrument of political pressure**

Moscow (Russian Federation) - 20-21 November 2006

Monday 20 November 2006

- 9.35 am Arrival at Sheremetievo airport, transport to Moscow
- 17.30 pm Meeting with Mr Vladimir Feigin, Deputy Chairman of the Management Board of the non-profit partnership, Gas Market Coordinator
- 19.30 pm Meeting with Mr Andrei Dementiev, Deputy Minister of Industry and Energy of Russian Federation

Tuesday 21 November 2006

- 9.00 am Participation at International Gas Forum "Gas of Russia 2006" at Gazprom
- 14.00 pm Meeting with Mr Vladimir Milov, President of the Institute of Energy Policy
- 16.30 pm Meeting with Mr Konstantin Kosachev, Head of the Russian Delegation to the Parliamentary Assembly of the Council of Europe

Wednesday 22 November 2006

- 9.00 am Departure for the airport

Reporting Committee: Political Affairs Committee.

Reference to Committee: Ref. No 3168 on 23.01.06

Draft resolution and draft recommendation adopted by the Committee on 11 December 2006

Members of the Committee: Mr Abdülkadir **Ateş** (Chairman), Mr Konstantion **Kosachev** (Vice-Chairman), Mr Zsolt Németh (Vice-Chairman), Mr Giorgi **Bokeria** (Vice-Chairman), Mr Miloš **Aligrudić**, Ms Birgir Ármannsson, Mr Claudio Azzolini, Mr Miroslav Beneš, Mr Radu-Mircea Berceanu, Mr Alexandër Biberaj, Ms Raisa Bohatyrjova, Mr Luc **Van den Brande**, Mr Lorenzo Cesa, M. Mauro Chiaruzzi, Ms Elvira Cortajarena (alternate: Mr Julio **Padilla**), Ms Anna Čurdová, Mr Noel Davern (alternate: Mr Patrick **Breen**), Mr Dumitru Diacov, Mr Michel Dreyfus-Schmidt, Ms Josette Durrieu, Mr Mikko **Elo**, Mr Joan Albert Farré Santuré, Mr Pietro Fassino (alternate: Mr Pietro **Marcenaro**), Mr Per-Kristian Foss, Mr Jean-Charles **Gardetto**, Mr Charles Goerens, Mr Daniel Goulet, Mr Andreas **Gross**, Mr Jean-Pol **Henry**, Mr Serhiy Holovaty, Mr Joachim **Hörster**, Mr Tadeusz **Iwiński**, Mr Elmir Jahić, Mr Miloš Jeftić (alternate: Mr Dušan **Proroković**), Mr Oskars Kastēns, Ms Darja Lavtižar-Bebler, Mr Göran **Lindblad**, Mr Younal **Loutfi**, Mr Mikhail Margelov, Mr Tomasz **Markowski**, Mr Dick Marty, Mr Frano Matušić, Mr Murat **Mercan**, Mr Jean-Claude Mignon, Mr Marko **Mihkelson**, Ms Nadezhda Mikhailova (alternate: Mr Ivan **Ivanov**), Mr Aydin Mirzazada (alternate: Mr Sabir **Hajiyev**), Mr João Bosco Mota Amaral, Ms Natalia Narochnitskaya, Mr Grygoriy Nemyrya, Ms Carina Ohlsson, Mr Theodoros Pangalos, Ms Elsa Papadimitriou, Mr Christos Pourgourides, Mr Gordon **Prentice**, Mr Gabino **Puche**, Mr Lluís Maria de Puig, Mr Jeffrey Pullicino Orlando, Mr Andrea **Rigoni**, Lord **Russell-Johnston**, Mr Oliver Sambevski, Mr Peter Schieder, Mr Ingo Schmitt, Mr Adrian Severin, Ms Hanne Severinsen, Mr Samad **Seyidov**, Mr Leonid **Slutsky**, Mr Michael Spindelegger, Mr Rainer **Steenblock**, Mr Zoltán Szabó, Baroness Taylor of Bolton (alternate: Lord **Tomlinson**), Mr Mehmet **Tekelioğlu**, Mr Tigran Torosyan, Mr José Vera Jardim, Ms Biruté **Vesaitė**, Mr Varujan Vosganian, Mr David **Wilshire**, Mr Bart van Winsen, Mr Wolfgang Wodarg, Ms Renate Wohlwend, Mr Boris Zala, Mr Krzysztof Zaremba (alternate: Mr Karol **Karski**).

Ex-officio: MM. Mátyás Eörsi, Mats Einarsson,

N.B. : The names of the members who took part in the meeting are printed in **bold**

Head of the Secretariat : Mr Perin

Secretaries to the Committee: Mrs Nachilo, Mr Chevtchenko, Mrs Pieter, Mrs Dadoun